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# HANDBOOK ON MERCANTILE LAW

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Negotiable Instruments.*

**With a foreword by**

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## FOREWORD



*Here is a book which deserves commendation in more ways than one.*

*The author has, rightly in my opinion, realised the importance of a general knowledge of the law of Contracts for a proper understanding of Company Law or the Law of Insolvency or the other branches of what is generally described as Mercantile Law, and has done well in including a statement of the general law of contracts in Part I of his book. It is further noteworthy that in the treatment of the general law of contracts as also in dealing with particular branches of Mercantile Law Mr. Venkatesam has, while avoiding prolixity, referred in sufficient detail to leading decisions, English and Indian. There are apt quotations in appropriate contexts from leading text-writers like Pollock, Salmond and Anson. The discussion of the law is quite up to date and one notes with great interest that the present trends including even the recommendations of the Law Reform Committee of England come in for suitable mention in more than one place. I am again impressed by the analysis and precision characterising the book throughout.*

*The author has made the modest claim that he intends the book to be a suitable text book on Mercantile Law for students appearing for the B. Com., degree examinations of the several Indian Universities and the R. A., examination held by the Government of India. I regard the book as much more than that. India is on the threshold of an era of expanding commerce and industry. Her young business men and industrialists would apart from enterprise, talent and character need as a part of their educational equipment a general but sound knowledge of the basic principles of the Law of Contracts both general and special. I cannot recommend a more suitable book for the purpose than the present one. I may also add that this marvellous book of five hundred odd pages packed with information would be a helpful aid to memory to lawyers and to those engaged in the administration of justice.*

*"White House"  
Luz Avenue.  
19th Sept. 1946. }*

**Y. GOVINDARAJACHARI.**

(JUDGE, HIGH COURT, MADRAS)



## PREFACE

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With the idea of providing a suitable text-book on 'Mercantile Law' for students appearing for the B. Com., Degree examinations of the several Indian Universities, and the R.A., Examination held by the Government of India, I commenced writing on the subject some years ago, when I was a lecturer in Mercantile Law in the Andhra University. But due to reasons beyond my control it could not be finished then, and it was only last year that I was able to resume and complete it.

I have divided the book into two parts. The first part deals with the law relating to Contracts (General), Bailments, Indemnity and Guarantee, Agency, Sale of Goods, Partnership, and Negotiable Instruments. The second part deals with the law relating to Companies, Insolvency, Carriers and Shipping, Insurance, Securities and Arbitration. Since the syllabus of some of the Universities includes Industrial Law, I have added in the appendix a summary of the important provisions of the Indian Factories Act, Workmen's Compensation Act, Trade Disputes Act, Trade Unions Act, and Societies Registration Act.

Though I am fully aware of the risk involved in trying to present this very extensive branch of the law in a short compass, I have undertaken it with the hope that the commerce students—who can ill afford to study the law in great detail—would find their needs satisfied by this volume. I have given reference to the sections of the Indian Statutes, wherever necessary, and where they are involved or lengthy the essential ingredients have been numbered, in order to facilitate their being easily remembered. References have been made to leading decisions, English as well as Indian, and the facts of some important cases with the *ratio decidendi* have been given in smaller type.

I acknowledge my indebtedness to Halsbury's Laws of England (2nd Edition), Smith's Mercantile Law, and other

valuable treatises on the several topics dealt with in this book, from which I derived considerable help.

I offer my grateful thanks to the Hon'ble Mr. Justice V. Govindarajachari for having readily consented to write a foreword to this little work of mine.

I take this opportunity of expressing my thanks to my friends Messrs. P. S. Raju, and S. V. Venugopalachary, Advocates, High Court, Madras, for their kind help and assistance. My thanks are due to Mr. V. C. Vasudevan, B.A., Proprietor 'India Printing Works' for the very neat and quick execution of the work in spite of several difficulties.

I shall consider my endeavours to have been amply rewarded if this book is found useful by the students, for whom it is primarily intended.

Mylapore, }  
MADRAS. }  
12-8-1946 }

E. VENKATESAM

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# **PART I**





# CHAPTER I

## INTRODUCTORY

Mercantile Law is the name given to that branch of law which is generally applied to cases arising out of mercantile transactions. It is of somewhat elastic proportions but is generally understood to include general principles of law of contracts (also called General Contracts), and law of Special Contracts e.g. Indemnity and Guarantee, Agency, Partnership, Sale of Goods, Companies, Insurance, Negotiable Instruments, and the Law of Insolvency or Bankruptcy etc.

This branch of law therefore relates to rights and obligations arising out of mercantile transactions between traders or mercantile persons. The question therefore arises, who is a trader or a mercantile person. The answer is that a mercantile person may be a single individual, or an association (group) of individuals acting collectively and carrying on trade, as in the case of a partnership or a Joint Stock Company.

Mercantile transactions relate mostly to what are known as movable properties or goods as distinguished from immovable properties. It is only in the case of movables that prices will be fluctuating every day, if not every hour, and thus provide excellent subject-matter for earning large profits and for speculation. Movable property is not confined to corporeal movables having a material form, like a bag of rice or a bale of yarn. Even incorporeal things having no material form like a debt due from a person, or a share in a company is a movable. Thus movables are of two kinds: (i) Chose-in-possession and (ii) Chose-in-action.

*Chose-in-possession* (thing-in-possession) means a corporeal movable whose possession can be maintained by the person having and entitled to legal possession, even by the use of force, and a suit for recovery of possession of that identical movable property can also be brought. Thus a gold ring is a chose-in-possession and if a thief tries to snatch it by force, the person in possession can, even by using reasonable force retain possession

of it and if he has lost its possession recover the identical ring in a court of law.

*Chose-in-action* (thing-in-action) means a claim which can only be enforced by an action in a court of law. For instance, if A executes a promissory note in favour of B for Rs. 100 and A is found walking along a road with a hundred-rupee note on a subsequent day it is not open to B to snatch it by force. The only right which A has is to enforce the claim through a court of law by taking suitable proceedings. Thus all negotiable instruments, (*i.e.*, promissory notes, bills of exchange or cheques) shares in companies, policies of insurance, debentures are choses-in-action.

It may however be noted that the principles of contract are applied even to non-mercantile transactions ; *e.g.*, where a plot of land is sold by A to B, both of them being 'non-mercantile' persons the order of performance by them has to be decided according to general principles of contract. Similarly a bill of exchange or a promissory note to which the parties are 'non-mercantile' persons will also be governed by the Negotiable Instruments Act.

*Sources of Mercantile Law*:—The principal sources of Mercantile Law in England are:—

1. The Law Merchant or *Lex Mercatoria*.
2. Acts of Parliament, or Statutes.
3. Common Law of England.
4. Principles of Equity.

*Lex Mercatoria*:—The most fruitful and ever-growing source of Mercantile Law is the Law Merchant or *Lex Mercatoria*, which is the name given to that bundle of customs and usages ordinarily recognized and enforced between merchants, and which became a part of the Common Law of England. The history of the growth of Law Merchant is really interesting, but it is beyond the scope of a book of this nature, to deal with it at length. At first, the Law Merchant consisted only of the customs and usages of that small body of men who were traders. They had their separate courts called *Courts pépoudrous*, because they settled the disputes of litigant tradesmen while the dust fell from their feet *i.e.*, with such quick and simple procedure. These Courts were incident to fairs and markets and were presided over by merchants well-versed in those usages, but about the middle of the 18th Century the Common Law Courts in England, envying the

jurisdiction exercised by these non-official Judges grappled it, and in so assuming jurisdiction, had recognised the practices and customs of merchants. These trade usages which were so recognized became part of the English Common Law and acquired the technical name of Law Merchant. But in order that a custom among merchants may be recognized as a principle of law, it may not be very old, but it should be general and notorious, though of recent usage. With lapse of time fresh customs grew up amongst traders, and after acquiring general usage they became part of Law Merchant, which is therefore an ever growing branch of Law expanding and modifying itself within certain limitations, with the changing needs of trade and commerce. It is not a closed book nor is it fixed or stereotyped. *Bank of Baroda Ltd. v. Punjab National Bank Ltd. & others.* (1944) 2 M.L.J. 275 (P. C.).

*Acts of Parliament, or Statutes* :—Statute Law is the law laid down in Acts of Parliament. Having the sanction of the State, it is undoubtedly the most superior and powerful source and it over-rides any rule of Common Law or Equity.

*Common Law of England* :—Common Law is the phrase used in England to denote the law as can be gathered from the decisions of Judges and text-books. This law is based upon judicial precedents handed over from generation to generation. Common Law existed in England even prior to the creation of the Parliament, and is, therefore, a very potential source of Law in the country. This is also called the unwritten law, thereby meaning that it is not written in any Statute or Act of Parliament. For instance the law of contracts is even to-day, a part of the Common Law of England and is not codified as in India.

*Principles of Equity* :—The courts established in the 12th century by King Henry II, called the Common Law or King's courts, were governed by an archaic system of procedure with peculiar forms of *writs, actions* etc., which prevented relief being granted by the courts, except in cases to which one or the other of the writs applied, and confined the remedy only to damages or compensation in money. In several cases therefore either legal proceedings were not entertained, or if entertained satisfactory remedy was not granted by the Common Law Courts. Consequently suitors approached the Chancellor, who as a representative of the King not only entertained novel actions, but also granted relief, unfettered by the procedure of the Common Law

Courts, but based on notions of justice, equity and good conscience. The courts originally presided over by the Chancellor and later on by other Judges to discharge his duties, were known as the Chancery or Equity Courts. The Equity Courts were not bound to grant relief in every case, as it was always a matter in their discretion. Thus, for instance, there are two maxims on which the Courts of Equity act: *viz.* "He who seeks equity must do equity" and "He who comes into equity must come with clean hands." In course of time, the rules governing the Equity Courts and the Equitable Reliefs, became fixed like the Common Law and for some time in England, these two classes of courts were functioning side by side until the passing of the Judicature Act of 1873. After the passing of that Act the separate existence of those Courts was abolished, but each division of the High Court of Justice was empowered to grant either or both the remedies (Common Law as well as Equitable) according to the circumstances of the case. Where there is a conflict between the rules of Common Law and the rules of Equity the latter prevailed. It may be noted that the remedies of specific performance of contracts, injunction, rectification and cancellation of contracts are all equitable remedies.

In India, Mercantile Law, as such, is not to be found in the Ancient Texts excepting for stray principles that can be gathered here and there like the Rule of Damdupat, which lays down that a plaintiff cannot recover by way of interest an amount exceeding the principal. The Mercantile Law of England with such modifications, as introduced by the various Acts of the Central and Provincial Legislatures, is the foundation for the Indian Law. Hence, besides the sources enumerated above, the following constitute additional sources of Indian Mercantile Law, *viz.*,

- (1) Acts of the Legislatures (Federal as well as Provincial).
- (2) Customs amongst native merchants.

Prior to the passing of the Indian Contract Act 1872, the English Common Law, with some modifications suitable to Indian conditions, was for some time applied by the British Indian Courts. But after 1781 the Courts at Madras, Bombay and Calcutta applied the Hindu Law where the parties were Hindus and Mahomedan Law where they were Mahomedans, and the Law of the defendant where the parties belonged to different communities.

The Indian Contract Act IX of 1872 which came into force on 1st September 1872 substantially embodies the principles of the English Law, and the sections referred to hereafter relate to the said Act. It repealed several enactments, but did not supersede all native usages and customs, which are not inconsistent with it. Moreover, the Contract Act as the preamble itself indicates is not exhaustive, but it only lays down the principles relating to contracts in general and certain special contracts, *viz.*, Bailments, Indemnity, Guarantee, and Agency. The Law relating to Sale of Goods and Partnership originally formed part of the Contract Act. It has been later repealed and is now contained in two different Acts *viz.* the Indian Sale of Goods Act, III of 1930, and the Indian Partnership Act, IX of 1932. The Law relating to Negotiable Instruments, Carriers, Railways, etc., are all dealt with by separate Acts.

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## CHAPTER II

### A GENERAL VIEW AND DEFINITION OF CONTRACT

*Object of the Law of Contracts* :—Though the study of the Law relating to Contracts is mainly the province of Lawyers still ‘contract’ is the foundation of the civilised world, and every one of us will be entering into a number of contracts from sunrise to sunset, without our least knowing it. Whether it be for the purchase of a cup of tea or for having a shave in a saloon, or for a trip in a tramcar, or for witnessing a picture in a theatre, only to name a few, one will be entering into a contract. As Sir William Anson says, “The object of Law is order and the result of order is that men are enabled to look ahead with some sort of security as to the future. Although human actions cannot be reduced to uniformities of nature, men have yet endeavoured to reproduce by law something approaching to this uniformity. As the Law relating to property had its origin, in the attempt to ensure that what a man has lawfully acquired, he shall retain, so the Law of Contract is intended to ensure that what a man has been led to expect shall come to pass, that what has been promised to him shall be performed.” Thus the object of the Law of Contracts is to deal with *rights in personam* as distinguished from *rights in rem*. For instance if A has a right to recover a sum of money from B that right can be exercised only by A but not by others, because the right which A has against B, is a right *in personam*. For this very same reason, A cannot enforce that right against anyone else except B. A *right in personam* has to be contrasted with a *right in rem*. For instance, if A owns a plot of land and B is the adjacent owner, the right of A to have uninterrupted possession and enjoyment of that land is available not simply against B but against every member of the public. Similarly, everyone excepting A is under an obligation not to interfere with A’s possession or enjoyment, because the rights of A with respect to that plot of land are rights *in rem*. Thus rights to property are all rights *in rem* while contractual rights are rights *in personam*.

*Obligation, Agreement and Contract* :—The juristic conception of a contract consists of two correlated elements, *viz.*, obliga-

tion and agreement. An *obligation* is defined as a legal tie which imposes upon a person or persons, the necessity of doing or abstaining from doing a definite act or acts. Obligation is also called *vinculum juris*. The essentials of obligation are :—

- (1) There must be two persons.
- (2) The obligation must relate to definite act or acts.
- (3) The obligation must relate to legal matters and not to social affairs, *e.g.*, a promise to entertain etc. *Balfour v. Balfour* (1919) 2 K. B. 571.

An *agreement* in order to create an obligation should satisfy the above requirements and also the following.

(4) *Identity of mind* :—Both the parties must have agreed about the subject-matter at the same time and in the same sense, or in other words there should be *Consensus-ad-idem*, before there can be an agreement.

(5) *Mutual communication* :—The parties should express their willingness to enter into an agreement in some understandable way *i.e.*, there should be, communication of their respective intentions, *Felthouse v. Bindley*; (1862) 142 E. R. 1037.

Thus for consideration received by him if A promises to sell his car to B, there is an agreement between A and B, which gives rise to an obligation on the part of A to deliver that car, and is therefore a contract. But there are several kinds of agreements which do not give rise to obligations, and are therefore not contracts. They are (1) agreements which transfer rights from one person to another, like assignments and coveyances; (2) agreements which destroy rights or obligations like release and surrender. They are not contracts because there are no outstanding obligations to be performed or enforced. It may however be noted that there may be some anomalous agreements which transfer or destroy rights, and also create some outstanding obligations.

Thus every contract is an agreement enforceable at law but every agreement is not a contract.

Just as every agreement does not give rise to an obligation, every obligation does not necessarily spring from an agreement.

An enforceable obligation may result from :

- (1) Torts or Civil wrongs.
- (2) Quasi-contracts.



(3) Judgments of Courts.

(4) Relationship between husband and wife, trustee and beneficiary.

The Law of Contracts therefore excludes all other sources of obligation except valid and enforceable agreements. Hence Sir John Salmond rightly observes : "The law of contracts is not the whole law of agreements, nor is it the whole law of obligations. It is the law of those agreements which create obligations, and those obligations which have their source in agreements."

The word contract is also used in the following contexts :—

(i) contracts of record (i.e. judgment, of courts), and

(ii) formal contracts, or specialty contracts, or deeds i.e., contracts in England which are signed, sealed and delivered. It may be noted that a specialty contract does not exist in India.

*Definition of contract :*

Sir William Anson defines contract as : "a legally binding agreement between two or more persons by which rights are acquired by one or more to acts or forbearances on the part of the other or others."

According to Section 2, clause (h) a contract is "an agreement enforceable by law." Section 2 (e) enacts : "every promise, or every set of promises forming consideration for each other, is an agreement." Promise, in its turn, is defined in Section 2 (b) thus : "When the person to whom a proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise." A proposal is defined in Section 2 (a) as follows : "When one person signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of that other, to such act or abstinence, he is said to make a proposal."

Section 10 lays down : "All agreements are contracts if they are made by the free consent of parties, competent to contract for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void."

A careful examination of these provisions would reveal that in order that a valid contract may be formed the following conditions should be satisfied.

*Essentials of a contract :—*(1) *Consensus-ad-idem*, i.e., the two parties must have agreed about the subject-matter of the contract

at the same time, and in the same sense; in other words, there must be identity of minds. For example, if A who owns two houses, one at Madras and another at Calcutta, offers to sell B one house, himself intending it to be the one at Madras, while B accepts the offer, thinking that it is the house at Calcutta, there is no consensus and the contract is therefore void.

(2) The other important element is "consideration", which is understood as, some matter accepted or agreed upon as a return or equivalent for the promise. This requirement is insisted upon to show that the parties deliberately intended that the promise should be attended by legal consequences. All simple or parol contracts must be supported by consideration; otherwise they are gratuitous and void. In England however the element of consideration is not insisted upon in the case of formal contracts or specialties, but there is no corresponding contract in Indian Law.

(3) The parties must have capacity to contract, *i.e.*, neither of them should suffer from any incapacity to enter into a contract, either on account of status, as in the case of foreign sovereigns, ambassadors, etc., or on account of mental deficiency, as in the case of minors, etc. In these cases, the contracts are void.

(4) There should not be any flaw in the consent of parties. A consent may be defective either on account of mistake in the minds of the parties or on account of the consent not being free. In cases of mutual mistake, the contract cannot be said to possess the first essential viz. *Consensus-ad-idem* and the contract would be void. But in cases where undoubtedly consent is present, but it is obtained by some unfair means like coercion, fraud, misrepresentation, or undue influence, the contract is voidable.

(5) The consideration as well as the object of a contract must be lawful. If A promises to pay Rs. 100 to B for murdering C, though it may satisfy all the other requirements, the promise cannot be enforced because the consideration is clearly illegal. Similarly, in a case where A promises to pay B Rs. 100 for letting B's house for the avowed purpose of running a brothel, which object is made known to B, the promise between A and B, though apparently valid, will not be enforced in a Court of Law, because, the object of the contract is clearly illegal. In both these cases the contract is void.

*Valid, Void, Voidable and Unenforceable contracts* :—As already observed, every contract is an agreement, while every agreement may not be a contract. The essential elements of a contract have been enumerated above and unless they are satisfied, an agreement will not be valid, i.e., will not amount to a contract, but will only be a void, or voidable agreement. In ordinary usage, the terms valid contract, void contract, voidable contract, and unenforceable contract are also used, but the word 'contract' only stands for agreement in that connection.

*Valid contract* therefore means an agreement which possesses all the requisites of a contract.

*Void contract* is an agreement without any legal effect. It may be on the very face of it (*prima facie*) void, or some proof may be necessary to show that the agreement, though apparently valid, is really void. A contract may be void from the very beginning (*ab initio*) or it may become void subsequent to its formation. A void contract is not enforceable at the instance of either party. Section 2, clauses (g) and (j) lay down the rule thus: "An agreement not enforceable by law is said to be void", and "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable". Examples of a void contract are : a contract by a minor, or lunatic to purchase goods which are not necessities; a contract regarding the subject matter of which both parties are under a mistake; or a contract which is not supported by consideration, or even if supported by consideration it is unlawful or illegal.

*Voidable contract* is defined by Section 2, Clause (i) as "an agreement which is enforceable by law at the option of one or more of the parties thereto but not at the option of the other or others." Voidable contract is therefore valid till it is set aside by the party entitled to avoid it. The distinction between a void contract and a voidable contract is very important, because in the case of a void contract even third parties cannot acquire any right from a person claiming under such contract, while in the case of a voidable contract, third parties can acquire a valid title from a person claiming title under such a contract, if the said title has been acquired by them before the contract is set aside by the person entitled to do so. A voidable contract should be distinguished from a contract which can be terminated at the will of one of the parties. Examples of voidable contracts are : where A obtains the consent of B to a contract by practising fraud, coercion or undue influence.

*Unenforceable contract* is a contract which is otherwise valid but cannot be enforced on account of some technical defect, like want of stamp or bar of limitation.

Contracts are sometimes classified as (i) Unilateral and (ii) Bilateral. In the case of a unilateral (*one-sided*) contract, at the time of its formation, one party to the contract has performed his part and the obligation will be outstanding only against the other. For example, if a railway porter carries a passenger's luggage and places it in his carriage, the contract springs into existence only when the passenger allowed the porter to perform services, which are not intended to be gratuitous, and which have been accepted by the passenger. Therefore till the luggage has been placed in the carriage, there is no contract at all, and by the time the contract comes into existence the cooly has performed his part of it, and the passenger alone remains liable to pay reasonable charges. In this type of cases since the consideration for the contract (*viz.*, rendering of the services by the cooly) was executed or performed by the time of formation of contract they are called *contracts with executed consideration* or *executed contracts*. In the bilateral (two-sided) contract, at the time of its formation there are two outstanding obligations, one on either party to the contract. A promises to paint a picture in three months in return for which B promises to pay Rs. 100. Here there are two promises and each party can hold the other liable for the breach of his promise. In this type of cases since the promises which are reciprocal have to be performed in future they are called *contracts with executory consideration*, or *executory contracts*.

Yet another classification of contracts is : (1) Express, (2) Tacit and (3) Implied.

Express contract is defined by Section 9 as "one entered into by words spoken or written."

A contract is said to be tacit when it has to be inferred from the conduct of parties, *e.g.*, where A enters a bookstall, takes out a book, places on the counter the price of the book and walks away with it. In this case the offer as well as acceptance have to be inferred from the conduct of the parties. Similarly in the case of obtaining a ticket in an automatic machine, or getting into a tram car. In the latter case the act of getting into the car is an offer by the passenger to travel, subject to the company's rules regarding

payment of fare, etc., and the act of the conductor in permitting him to sit is the acceptance of that offer. This kind of contract is also called implied contract, but it is not correct, because an implied contract is used only to mean a quasi-contract.

'Implied contract' or 'quasi-contract' or 'constructive contract' means a contract implied by law, where there is none. For example, if A pays money by mistake to B, while it is really due to C, the law implies a contract and creates an obligation on the part of B to refund that money to A, though there has been no such promise by B at the time of receiving that money.

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## CHAPTER III

### OFFER

According to Sir William Anson, every contract can be analysed into an offer by one party accepted by the other. This test for ascertaining the existence of a contract in a particular set of circumstances holds good in most of the cases. An offer is also called a proposal and is defined in Section 2 (a) thus "When one person signifies to another his willingness to do or abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal." A writes to B saying that he is willing to sell his house if B is willing to pay Rs. 1,000. A is said to make an offer and if B writes agreeing to that proposal it is called an acceptance, and A is called the offeror and B the offeree.

The requisites of a valid offer are as follows :—

(1) An offer must contain terms which are definite of capable of being made definite.

In *Montreal Gas Co. v. Vasey*, (1900) A.C. 555, a clause in the agreement that the Company would favourably consider the application of the other party to it for a renewal of that contract after its expiry, was held not to bind the Company.

In *Taylor v. Portington*, (1855) E. R. 128, A promised B to take a lease of a house for 3 years at £85 per annum, if the house were put into thorough repair and the drawing rooms decorated according to present style. Held that the terms were too uncertain, and that the promise could not be enforced.

(2) An offer must be one intended to give rise to legal consequences.

• In *Balfour v. Balfour*, (1919) 2 K.B. 571, a husband promised to send £30 a month to his wife so long as she remained away from him. Held that the wife could not sue for the amount, because the promise made by the husband was never intended to give rise to legal consequences.

Where an agreement clearly provided that it shall not be subject to legal jurisdiction in the law courts, it was held that there was no contract made between the parties. *Rose & Frank Co., v. Crompton Bros., Ltd.*, (1925) A.C. 445. Also *Thyagaraja Mudaliar v. Vedathanni* 59 Mad. 446 (P.C.). A condition excluding

legal liability is not contrary to public policy, but is binding. *Apple-son v. Littlewood Ltd.*, (1939) 1 A.E.R. 464.

(3) An offer must be distinguished from a quotation, or an offer to *chaffer*.

In *Harvey v. Facey*, (1893) A.C. 532, X telegraphed to A "Will you sell us Bumper Hall Pen? Telegraph lowest cash price. Answer paid." A replied by telegram "Lowest price B. H. Pen £ 900." X telegraphed "We agree to buy B. H. Pen for £ 900 asked by you." In a suit by X against A, held that the mere statement of the lowest price at which the vendor would sell contains no implied offer to sell at that price and that in this case there was no reply to the question whether A agreed to sell the property. It was therefore held that there was no concluded contract between the parties.

In auction cases the question often arises whether an auctioneer who announces sale by auction can withdraw an article from the sale.

In *Harris v. Nickerson*, (1873) 8 Q.B. 286, plaintiff filed a suit for recovering his expenses in attending an auction sale of certain furniture, which was advertised to be sold, and which was in fact withdrawn just before the sale. Held that the plaintiff must fail because mere advertisement to sell was no offer, which can ripen into a contract by the intending purchaser accepting the same by attending the auction.

On the other hand the highest bid at any instant of time is an offer, which if accepted by the auctioneer, would result in a contract. It therefore follows that an auctioneer can withdraw an article at any time, before it is knocked down. The Indian Law is the same. *Agra Bank v. Hamlin*, (1891) 14 Mad. 235. The same rule applies even to court sales, as has been held in *Raja of Bobbili vs. Akella Suryanarayana Rao*, 42 Mad. 776.

It may therefore be noted that in the case of auction sales an auctioneer can withdraw an article advertised for sale, and the bidder can retract his bid before it is accepted by the fall of hammer and that the auctioneer can refuse to knock down the goods in favour of the highest bidder. In India the law is now laid down in Section 64, Indian Sale of Goods Act, thus :

"In the case of sale by auction, the sale is completed, when the auctioneer announces the completion by the fall of the hammer, or in other customary manner ; and until such announcement is made every bidder may retract his bid."

In railway cases, a question often arises whether the terms contained in the railway time table amount to an offer, or only an invitation to offer. Sir F. Pollock is of the view that since the

ticket is issued in regular course only against payment, the railway company should be deemed to be making an offer by tendering the ticket, and that the contract is formed only by acceptance of the ticket immediately after payment of the fare. According to the learned author railway time tables, announcements of shipping companies and the like, though they contain the terms of the agreement contemplated between them and the public, and those terms will be binding on any one whose attention has been sufficiently drawn to their existence, yet they do not constitute actual offers of a contract to be completed by any member of the public by acting on them. (Pollock's Principles of Contract 11th Edn., Page 48). In *State Aided Bank of Travancore Ltd., v. Dhirt Ram*, I.L.R. (1942) Bom. 318 (P.C.), it was held that a bank's letter with quotations as to particulars of interest on deposits, in answer to an enquiry is not an offer, but a quotation of business terms, and that the contract was made by the offer of the party in the opening form, accepted by the bank by the issue of deposit receipt. Therefore a misleading announcement of the timings of trains by railway companies in their time-tables will be actionable only in Tort, if that statement amounts to fraud or deceit and not on the basis of a contract.

(4) An offer may be to an individual or to public at large. Offers to the public are by Sir John Salmond, called "offers at large" as distinguished from "offers to individuals," also called "specific offers:" e.g., if A promises to give Rs. 10 to B, if he brings back his missing son, this is an offer to an individual, but if A issues a public advertisement to the effect that he will give Rs. 10 to anyone who brings back his missing son, that is an offer at large or a general offer, and any member of the public can accept the said offer, by searching for and bringing back the missing son.

The leading case on this point is *Carlill v. Carbolic Smoke Ball Co.* (1893) 1 Q. B. 256, where the defendant company the proprietor of the "Carbolic Smoke Ball," a remedy for treating the nostrils and air passages issued an advertisement offering £100 as reward to any person who should contract influenza after having used the smoke ball three times daily for two weeks as per printed directions. It also added that £1,000 were deposited in the Alliance Bank showing the sincerity of the defendant company in the promise. The plaintiff, a lady, bought the Smoke Ball and used it for more than two weeks and even while using it, had an attack of influenza. When she sued for the reward, it was held that she could recover the same because the advertisement in this case was not a mere invitation to offer but an offer at large, which was accepted by the defendant giving rise to a binding contract. This case is very important as it lays down the following principles:—



(i) An advertisement need not always be a mere invitation to offer. It may be an offer itself in certain cases.

(ii) An offer though made to the entire public and not to anyone in particular is not a mere offer to negotiate but an offer itself which can ripen into a contract with anybody who performs the conditions of the offer.

(iii) Though an acceptance of a proposal should be generally communicated, since it is for the benefit of the offeror, he may dispense with such notification or may be willing to receive, a communication of the acceptance along with a notice of performance by the acceptor ;

(iv) The mere extravagance of an offer or the probability of the promisor being subject to a number of suits, is no ground for exonerating a party from a contract otherwise valid.

It should however be noted that a *general offer* is different from a *standing offer* or a *tender*. A *tender* is in the nature of a continuing offer, but it is not necessarily and is not generally an offer to the entire public : *e.g.*, if A offers to supply B coal at a particular rate for a period of two years from a specified date and if accepted, it is called a tender. In this case B is not bound to place an order with A for all the coal, or any part thereof, which he requires, and A is not bound to keep that offer alive during the period of two years, unless there is extra consideration for that promise. But the moment B places an order for a part of the quantity it will be an acceptance, and the offer will be converted into a contract to that extent, and A is bound to supply coal at the rate promised by him. *Offord v. Davies and another*, (1862) 142 E. R. 1336.

Where for consideration A agrees not to revoke the offer during the said period of two years, it is called an *option*, and it will be binding on A.

The offeror may attach any condition he pleases to the offer, and prescribe any mode of acceptance. As nobody is compelled to accept an offer, it follows that there cannot be a valid acceptance until all the terms of the offer are complied with, however ridiculous they may be.

(5) Every offer must be communicated to the offeree. Since a contract requires identity of minds, unless the offeree is aware of the offer, there can be no acceptance, much less, a contract. The rule is the same in the case of specific as well as general offers. In *Fitch v. Snedakar*, an American Case, a person gave information without knowing that a reward was offered for it, but claimed that amount subsequently. Held that since he was not

aware of that offer he could not have accepted it, and therefore there was no contract on which he could sue. The same principle was laid down in *Lalman v. Gowri Dutt*. 11 A.L.J. 489.

Where the offer consists of several terms it is enough if a paper containing all the conditions has been delivered to the offeree or his attention has been drawn to their existence, *e.g.*, a railway ticket on the face of which is printed that the ticket is issued subject to regulations and conditions contained in the current time tables, etc., of the company. In such a case, it is no answer for the other party to say that he has not gone through the terms or read the conditions, and he will be bound by them. *Parker v. South Eastern Railway Co.* (1877) 2 C.P.D. 416 and *Thompson v. London Midland and Scottish Ry. Co.*, (1930) 1 K.B. 41. But in the case of an illiterate person or person with feeble sight or old age, the offeror should do what all is reasonably necessary to draw the attention of the acceptor to the existence of those terms. *Richardson v. Rowntree* (1894) A. C. 217. A receipt for payment of money is not an offer and its acceptance does not make the terms printed on it binding on the person receiving it *Chapleton v. Barry U.D.C.* (1940) 1 K.B. 532.

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## CHAPTER IV

### Acceptance

Section 2 (b) defines an acceptance thus: "When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise." The same thing is humorously put by Sir William Anson thus: "An acceptance is to an offer what a lighted match is to a train of gun powder" thereby meaning that an offer once accepted explodes into a contract. The offeree when he accepts the offer is called an acceptor.

*Essentials of a valid Acceptance:*—(1) Acceptance should be communicated in some usual and reasonable manner. Since minds unexpressed cannot be taken note of by courts, every acceptance, like every offer, must be expressed by means of an external act, indicating the mental assent. The communication need not be of a particular kind or type, because that is always left to the discretion of the parties, but silence can never be prescribed as a mode of communication.

*Brogden v. Metropolitan Railway Company* (1877) 2 A.C. 666. The plaintiff to whom a written proposal was made, simply wrote on it "approved" and kept it in his table drawers. When he sued on the strength of the proposal, it was held that inasmuch as his approval or acceptance was not communicated there was no contract at all.

*Felthouse v. Bindley*, (1862) 142 E.R. 1037. An uncle wrote to his nephew offering to purchase his horse for a particular price and also added that in the event of his nephew not replying him, he (uncle) would consider the proposal to have been accepted. The nephew did not communicate the acceptance. Held there was no contract.

According to English Law where the acceptance of the offer is not communicated in the mode prescribed but by some other mode it will not be a valid acceptance resulting in a contract. According to Sec. 7 (2) the Indian Law is less rigorous and it imposes a duty on the offeror to insist, in a reasonable time after communication of acceptance, on the offer being communicated to him in the prescribed mode ; and if he fails to do so the acceptance, though defective in the mode of communication, shall be deemed to have been accepted by him,

(2) Communication of acceptance can be waived by the offeror. Since communication of acceptance is intended for the benefit of the offeror, he may if he so chooses waive it and such waiver may be inferred from the offeror recommending or suggesting a mode of acceptance which does not involve communication to him. For instance, if the offeror asks the offeree to fire a gun, or wave a flag in the event of acceptance and if that is done, there is sufficient communication of acceptance, and there is a concluded contract. In the case of *Carlill v. Carbolic Smoke Ball Company*, already referred to, the same rule has been laid down and it was held that the fact that Mrs. Carlill did not write to the Smoke Ball Co. about her using the smoke ball, did not render her acceptance invalid or ineffective, because the Smoke Ball Company in its advertisement never expressly or impliedly wanted any communication, apart from fulfilling the conditions mentioned in the advertisement.

(3) Acceptance should be made before the offer lapses or is revoked or rejected (*infra*). Once acceptance is made the offer becomes irrevocable.

(4) Acceptance should be absolute and unconditional. Therefore where an acceptance is made with variation or addition of certain terms to the original offer, it is not a valid acceptance but will only amount to a counter offer, which may or may not be accepted by the offeror.

*Lapse, revocation, and rejection of proposals :*

Lapse:—A proposal lapses :

(1) On the death of either the offeror or the offeree before acceptance. Even if there be acceptance by the offeree after the death of the offeror, or by the heirs of the offeree, after his death there cannot be in law *consensus-ad-idem*, and hence the offer must be deemed to lapse. According to English law even if an offeree accepts in ignorance of the offeror's death there will be no contract. But according to Sec. 6 (4) there will be a valid contract unless the offeree had knowledge of the offeror's death before acceptance. The rule is the same in the case of offeror's insanity.

(2) By the offeree not accepting the offer in the time prescribed, or where no time is prescribed, by lapse of a reasonable time without communication of acceptance. What is a reasonable time

is a question depending on the circumstances of the case. *Ramsgate Victoria Hotel Coy. v. Montefiore* (1866) L.R.I. Ex. 109.

**Revocation** :—An offer is revoked :

1. By the communication of revocation by the offeror to the offeree, before it is accepted by him. The offeree must have actual knowledge of the revocation and it is not enough for the offeror to say that the offeree was in a position to learn of the revocation, though in fact he did not have actual knowledge of it. Where a cheque was countermanded and a telegram was sent by the drawer to that effect in time, but it was not brought to the notice of the manager of the bank before the cheque was cashed, on account of the negligence of the bank's servants : Held that the cheque was not countermanded till the telegram was actually brought to the notice of the manager. *Curtice v. London City and Midland Bank* (1908) 1 K.B. 293. Also *Byrne v. Van Tienhoven* (1880) 5 C.P.D. 344 ; and *Dunlop v. Higgins* (1848) 1 H.L.C. 381.

If the offeror had disabled himself from fulfilling the offer and the offeree becomes aware of it, from whatever source it may come, the offer is revoked *Dickinson v. Dodds* (1876) 2 Ch. D. 463.

2. Even where an offeror agreed to keep the offer open for a specified time he may nevertheless revoke the offer before its expiry unless (i) the offer has been accepted before notice of the revocation reached the offeree, or (ii) offeror has agreed for valuable consideration not to revoke the proposal but keep it open during the time specified. *Cooke v. Oxley* (1790) 3 T.R. 653.

**Rejection** :—An offer is rejected :

1. If the offeree communicates his rejection to the offeror.
2. If the offeree makes a counter offer.
3. If the offeree accepts subject to conditions.

**Note** :—Except for the differences noted above, the Indian law relating to lapse, revocation, and rejection of proposal is the same.

**Contracts by Post** :—

The instant of time when an offeree signifies his acceptance so as to convert an offer into contract can easily be determined when the parties negotiate with each other face to face. But the question becomes somewhat difficult when the negotiations are carried on, as they are often done, through post. In such cases

the rules relating to communication of offer and acceptance may be stated as follows :—

1. An offer sent through post may be accepted by post, unless the offeror indicates some other mode of communication. The effect of an acceptance not communicated in the prescribed mode has been considered supra. Even if an offer is not sent through post, acceptance may be by post, if the circumstances indicate that the parties intended that post might be used. *Henthorn v. Fraser*, (1892) 2 Ch. 27.

2. An offer by post is made only when it reaches the offeree, and not when it would in the ordinary course of post reach him. *Adams v. Lindsell* (1818) 1 B & Ald 681.

3. An acceptance is complete the moment the letter of acceptance is posted (i.e., put in the post box) properly stamped and addressed, when the contract will be concluded. So the place where a letter of acceptance is posted will be the place where the contract is made. The reason for this is said to be that a letter properly addressed, stamped, and posted will ordinarily reach the offeror, and will be beyond the reach of the acceptor, and cannot be withdrawn. Thus even where a letter of acceptance was delayed in transit, and the offeror, after the posting of the letter of acceptance but before it reached him, revoked the offer, it was held that there was a valid acceptance and a binding contract. *Dunlop v. Higgins* (1848) 1 H.L.C. 381.

The same principle was laid down even in a case where the letter of acceptance was not simply delayed but lost. *Household Fire Insurance Coy. v. Grant* (1879) 4 Ex. D. 216.

This rule will not in practice result in hardship to the offeror when it is remembered that the offeror can always prescribe the mode of communication, or fix a time limit within which the communication of acceptance should reach him. There is one point of difference between English Law and Indian Law on this subject. According to English Law acceptance once made concludes the contract both for the offeror as well as the offeree, and the offeree cannot revoke his acceptance after posting it. But according to S. 4, "the communication of an acceptance is complete as against the proposer, when it is put in a course of transmission to him, so as to be out of the power of acceptor ; as against the acceptor, when it comes to the knowledge of the proposer ;" and S. 5 lays down:

“an acceptance may be revoked at any time before communication of acceptance is complete as against the acceptor but not afterwards.” Thus according to Indian Law an acceptor can revoke his acceptance before it actually comes to the knowledge of the proposer—say by sending revocation by telegram.

4. Revocation of an offer is not complete, both for the offeror as well as the offeree, until it reaches the offeree. *Byrne v. Van Tienhoven* (supra). Also *Henthorn v. Fraser* (supra).

The Indian Law is however different from the English rule, as S. 4 enacts that “the communication of a revocation is complete as against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it; as against the person to whom it is made when it comes to his knowledge”.

On account of this difference it looks as though in England a revocation of an offer can be revoked by the offeror before the revocation reaches the offeree, but that is not possible in India.

*Contract subject to formal document :—*

In cases where the parties intend to reduce the contract to a document, if the execution of the document is made a condition or term of the bargain without which the parties never intend to be bound by the contract, and if the document is not prepared, there is no valid contract at all. But if the parties only express a desire to reduce the contract to writing, the absence of the document does not make an otherwise completed contract invalid. Even the execution of a document does not make the contract contained therein enforceable, if the parties never intended it to be so.

*An agreement must be made :—*

The parties must always agree on the terms of their contract, and they cannot enter into an agreement to agree in future, in which case there will be no contract at all. There cannot be a contract to make a contract. If there is a material term of the future contract, which is not agreed expressly or by implication and which can be made definite only by further agreement between the parties there is no contract. *Scammell v. Ouston*, (1941) A. C. 251; (Balance of purchase money agreed to be paid on hire purchase terms: Held it was not a contract).

## CHAPTER V

### FORM AND CONSIDERATION

In England the only contracts that were recognised and enforced in ancient times were the speciality or contract under seal, and the Real Contract. All other contracts were called simple or parol contracts and came to be recognised only since the 16th Century. But the essential condition for the enforceability of simple contracts is *consideration*, and the rule is expressed by the Latin maxim: *Ex nudo pacto non oritur actio*, i.e., out of a nude pact no cause of action arises. In other words, all contracts which are not under seal should be supported by consideration. Otherwise they are called gratuitous promises and are void.

*Contract under Seal or Formal Contract.*—A formal contract or sealed covenant, which is also called a speciality, is nothing but a contract reduced to writing and signed, sealed and delivered by the promisor to the other party. According to English Law (i) contracts made without consideration, (ii) contracts made by corporations, and (iii) transfer of shares in companies etc., should be made under seal. The Common Law Courts considered it to be such a solemn act that it was sufficient in itself to give a right of action, and no proof was insisted upon regarding the existence of consideration. It may be noted that a speciality as such is not known in India, and is to be found only in England.

*Contract in writing.*—A contract under seal must be distinguished from a contract in writing. According to English Law certain classes of contracts, though they are simple, are required to be in writing. According to S. 4 of the Statute of Frauds (1677) contracts by executors or administrators, contracts of suretyship, and contracts which are not to be performed within one year are required to be in writing. According to S. 4 of the Sale of Goods Act, 1893, contracts for the sale of goods of the value of £10 or upwards should be in writing. In India there are no corresponding legal provisions and generally speaking a contract can be by word of mouth. But even in India certain contracts like bills of exchange and promissory notes, policies of Insurance, share certificates etc., can only be in writing and not oral. S. 10 lays



down "Nothing herein contained shall affect any law in force in British India, and not hereby expressly repealed, by which any contract is required to be in writing, or in the presence of witnesses, or any law relating to the registration of documents."

In 1765 Lord Mansfield, in the case of *Pillans v. Van Mierop*, (1765) 3 Burr. 1663, held that a contract required by law to be in writing viz., a bill of exchange, was enforceable even though it was not supported by consideration. But the House of Lords in *Rann v. Hughes*, (1778) 7 T. R. 350, n. negatived that view and held that even contracts which were reduced to writing according to the Statute of Frauds or the Law Merchant should be supported by consideration, and that otherwise they were void. This is the law till to-day.

*Definition of consideration* : It is defined in the case of *Currie v. Misa*, (1875) L.R. 10 Ex. 153 at 162 thus :

"A valuable consideration in the sense of the law may consist either in some right, interest, profit or benefit accruing to one party, or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other."

The definition given by Sir Frederick Pollock, which was approved by the House of Lords, is as follows :—

"An act or forbearance of one party or the promise thereof, is the price for which the promise of the other is bought and the promise thus given for value is enforceable."

Section 2 (d) of the Contract Act defines consideration thus :

"When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or abstain from doing something, such act or abstinence or promise is called consideration."

Consideration may therefore consist of the delivery of anything which has got a money value, or payment of money itself, or rendering some services, or doing an act which under law a person is not bound to do, or a promise to do any of those things. Thus if A promises to deliver a watch in return for Rs. 10 received by him from B, the benefit which A has gained, namely Rs. 10, is the consideration for the promise made by him, namely to deliver the watch. Looked at from another standpoint there is also loss, detriment, or inconvenience suffered by B in this case,

namely his parting with Rs. 10 in view of A's promise. As we shall presently see, the law insists more upon the presence of the element of detriment to the promisee (B) than upon the presence of benefit to the promisor (A). Similarly where A promises to pay Rs. 1,000 to B and B promises to deliver one hundred bags of rice there is a bi-lateral contract and the promise of A is said to be sufficient consideration for the promise of B and *vice versa*; or in other words one promise supports the other.

Even in India a contract which is not supported by consideration is void. Sec. 25 of the Contract Act lays down : "An agreement made without consideration is void," but it lays down certain exceptions to that rule and they are as follows :—

(1) where the contract is in writing and registered and made out of natural love and affection between parties standing in near relationship to each other ;

(2) where the contract is to compensate the person who voluntarily rendered services in the past. While according to Section 2 (d) past services rendered at the desire of the promisor constitute valid consideration, this exception recognises as valuable consideration, all past services—even those which are voluntary ;

(3) where a promise is made in writing and signed by the promisor to discharge a time-barred debt.

(Note :—The 3rd exception is really no exception at all, as will be seen later.)

*Rules as to consideration :—Consideration is essential to support every contract. A promise which is gratuitous, (made without consideration) is void.*

In *Abdul Azeez v. Mazum Ali*, 36 All. 268, A promised B to subscribe a sum of money for rebuilding a mosque, but failed to pay the amount. In a suit upon the promise, it was held that there was no consideration either in the sense of any benefit or advantage to A, or detriment to the promisee B, and that the contract was void.

In another case *Kedarnath v. Gorie Mahammad*, 14 Cal. 64, A promised B to subscribe a sum of money, for the construction of a Town Hall. On the faith of A's promise, B called for plans and entrusted the work to contractors and undertook certain pecuniary liabilities. In a suit against A it was held, that though consideration in the sense of benefit to A was not present, still consideration in the sense of detriment to B was present, because B undertook a liability on the faith of A's promise and the suit was decreed.

Where a newly admitted partner along with the existing partners acknowledged that on a particular day certain amount was due from the

partnership to its creditors, who thereafter made fresh advances to the new partnership and also reduced the rate of interest: Held that the fresh advances and reduction of the rate of interest were sufficient consideration for the undertaking of the new partner to pay the firm's old liabilities. It was also held that on account of a new partner being taken, the liability of the old debtor had been changed and a fresh and different liability had been substituted for that which formerly existed, and that novation in India (Sec. 62) as well as in England is a good consideration for a fresh promise. *Gowri Dutt Ganesh Lall Firm v. Madha Prasad and others*. (1943) 2 M.L.J. 417 (P.C.)

(2) *Consideration must proceed from the promisee*.—According to English Law if A pays £1 to B and in consideration of that payment B promises C to deliver a book to him, the promise of B to C cannot be enforced because consideration did not proceed from C, but from an altogether third person A. In other words it is said that C cannot enforce B's promise because C is a stranger to the consideration supplied by A. It was at one time thought that if A and C were closely related to each other, the consideration supplied by A was sufficient to support the promise made to C. *Dutton v. Poole*, (1688) 89 E. R. 352. But this exception was rejected in *Tweedle v. Atkinson*, (1861) 121 E. R. 762, where it was laid down that even if the stranger to consideration is related to the person who supplied consideration, the rule is the same.

But according to S. 2 (d) of the Contract Act, consideration may proceed from any party and not necessarily from the promisee. So in the above illustration C can enforce the promise made by B. *Chinnayya v. Ramayya*, (1881) 4 Mad. 137.

A stranger to consideration has however to be distinguished from a stranger to a contract, and the latter cannot sue in England as well as in India. For instance, if in consideration of some money received from A, B makes a promise to A to deliver an article to C, then the person who is to be benefited by B's promise is C, who is a stranger to consideration and also a stranger to contract, because there was no offer or acceptance between A and C. Therefore in this case if B commits a breach of the contract it is only A that can sue and not C. According to Indian Law also, C cannot sue because he is a stranger to the contract, though there is no objection on the ground of his being a stranger to the consideration. *Subbu Chetty v. Arunachalam*, 53 Mad. 270 (F.B.) *Jamanadas v. Ram Autor*, 34 All. 63 (P. C.).

The rule that a stranger to consideration, as well as a stranger to contract, cannot sue was laid down in England

in the leading case of *Dunlop Pneumatic Tyre Company v. Selfridge & Co., Ltd.* (1915) A. C. 847. Dew and Company, who were the agents for the sale of tyres of Dunlop Company on discount, entered into a contract with Selfridge Company whereby they agreed to pay £ 5 to Dunlop Company for every article sold by them (Selfridge Company) below the listed prices. Relying upon this contract of Selfridge Company, Dunlop Company filed a suit for recovery of £ 10 on the ground that two covers were sold by Selfridge Company contrary to the agreement. The House of Lords held that the promise made to Dew and Co., could not be enforced by Dunlop and Co., because they were strangers to the contract as well as to consideration.

To this rule that a stranger to a contract cannot sue there are two seeming exceptions in English Law, *viz.*,

(i) In the case of trusts the beneficiary may enforce the provisions in his favour, even though he is a stranger to the contract creating the trust.

(ii) In the case of acknowledgment of liability or estoppel; *e.g.*, where A receives money from B for paying it to C, and admits the receipt of that amount to C, then A constitutes himself the agent of C and will be liable to pay that amount to him.

Besides these two exceptions, there are two more exceptions according to Indian Law, *viz.* :

(iii) Where a promise is made to an individual for the benefit of a third party, and a charge on specific immovable property is created for the performance of that promise, then the third party, though a stranger to the contract, can proceed in equity to enforce the same. *Khwaja Mahammad v. Hussaini Begum*, 32 All. 410 (P.C.)

(iv) In cases of family arrangements between male members of a Hindu family which provide for the maintenance of marriage expenses of female members, the latter, though not parties to the contract, possess an actual beneficial right which places them in the position of beneficiaries under the contract and can therefore sue. *Shuppu Ammal v. Subrahmaniyam*, 33 Mad. 238 ; and *Sundararaja v. Lakshmi Ammal*, 38 Mad. 788.

(3) *Consideration can be executory or executed but cannot be past*—We have already seen that contracts are of two types,

namely (i) executed and (ii) executory, according as the consideration for the promise, is furnished at the time of promise, or is to be furnished in the future. According to English Law consideration in order to support a promise can only be executed or executory but not wholly past; or in other words past consideration is no consideration. The reason for the rule is that the remedy for contract evolved out of the law of torts.

To this rule of past consideration being no consideration there are certain seeming exceptions :—

(i) Where the past consideration was furnished at the request of the promisor, no definite promise of reward being made at the time, it was said that it constituted a valuable consideration for a subsequent promise in which the reward is defined for the first time. This rule was laid down in *Lampleigh v. Braithwait*, (1616) Hob. 105; but there is no satisfactory modern instance of this doctrine.

(ii) A previous moral obligation, it was said, constituted such relation between the parties that it was a valuable consideration for a subsequent promise. But this principle was rejected by the Exchequer Chamber in *Eastwood v. Kenyon*, (1840), 113 E. R. 482. In that case, J. an executor under a will, spent his own money for the education and maintenance of one S, the legatee. After attaining majority S and her husband promised to repay the money spent by J. In a suit upon that promise it was argued that the promise was not a nude pact but was supported by past consideration which was a valuable one, on account of the precedent moral obligation, but the court rejected that argument and held that the acceptance of such a doctrine would destroy the necessity for any consideration at all, inasmuch as the mere fact of giving a promise creates a moral obligation to perform it.

(iii) Where a debt is barred by limitation the debtor can waive the benefit of that plea and promise to discharge that debt. It is doubted whether this is an exception to the rule of past consideration because, as Sir F. Pollock says, "the Law of Limitation does not belong to the substantive law at all, but is a special rule of procedure made in favour of the debtor,"

This exception is found in S. 25 (3), Indian Contract Act.

Thus it may be seen that there are really no exceptions in English Law to the rule that past consideration is no consideration.

In India Sec. 2 (d) enacts, obviously following the decision in *Lampleigh v. Braithwait*, that if the past services were done at the request of the promisor it will be a valuable consideration for a subsequent promise of reward by the promisor. Further according to S. 25 (2) a promise to compensate wholly or in part a person who had already voluntarily done something for the promisor, or something which the promisor was legally compellable to do, is valid and enforceable. Under this clause it was held in some cases that a promise to pay a woman an allowance for past illicit cohabitation (which was not adulterous) was a promise to compensate for past services voluntarily rendered, and hence supported by consideration and enforceable.

4. *Consideration need not be adequate* :—It is not the province of Courts to see whether every person making a promise is deriving the maximum return or benefit for it, when such person has got the required capacity to enter into a contract. In other words, adequacy of consideration is always the look-out of the promisor. Thus if A promises to deliver a watch worth Rs. 100 only for Rs. 30, the inadequacy of the price by itself is not a ground for avoiding the contract. Similarly a promise by a person to give up chewing tobacco, or some other vice, is sufficient consideration for a promise by another to reward him. That is why it is said "A peppercorn may be good consideration for the release of £ 100."

But it may be noted that when a party pleads coercion, undue influence or fraud in the formation of contract, inadequacy of consideration will also be a piece of evidence which will be considered by the Courts along with other evidence in his favour.

5. *Consideration must not be illusory but should be real and competent*.—Consideration must be real, and if physical or legal impossibility of the thing promised makes it unreal consideration, e.g., if a man promises to make two parallel lines meet, or to discover treasure by magic, it is illusory consideration, and he cannot claim anything promised to him on the strength of such illusory consideration. Moreover consideration should not be vague.

*Forbearance to sue*.—Forbearance to sue even for a short time is valuable consideration but it must be shown that some liability was subsisting on that date. Thus if in consideration of the creditor not suing on the promissory-note executed by the debtor, he

promises to furnish security of immovable property, the promise by the debtor is valid and will be enforced.

*Compromise of disputed claims.*—When A sues to recover a debt of Rs. 1,000 from B, and B denies the debt altogether, and if a compromise is entered into between them by which B promises to pay Rs. 500 to A, this promise is perfectly valid and supported by consideration. The real consideration in this case is the detriment which A suffers in foregoing what according to him is a good claim for Rs. 500, and the benefit to A lies in his being relieved of the trouble and worry of establishing his non-liability in a Court of Law. *Callisher v. Bischoffheim*, (1870) 5 Q. B. 449. It must be noted that the promisee should have a *bona fide* claim which he is prosecuting or trying to prosecute honestly in a Court of Law. But if the claim is false to the knowledge of the promisee himself the consideration becomes unreal and the compromise will not be binding on the promisor.

*Composition with creditors.*—If a debtor finds himself financially embarrassed and calls for a meeting of all his creditors who agree to receive each a fixed proportion of the debt, then such an agreement is binding upon the debtor as well as all the creditors. This principle is on the same analogy as settlement of doubtful claims.

*Pre-existing legal obligation.*—If a person is already bound by statutory or official duty to do a particular act, the performance of that act cannot be the consideration for a promise. In *Collins v. Godefroy*, (1831) 109 E. R. 1040, a witness who was summoned by a Court, was promised by a person a sum of £6 for such attendance. In a suit on that promise it was held that the amount could not be recovered, because the witness was already bound to attend the Court according to summons, and as there was no extra detriment, the promise to pay him money was without consideration. Similarly an agreement to perform an existing obligation made with the person to whom the obligation is already owed is not one made for consideration *Vanbergen v. St. Edmunds Properties Ltd.*, (1933) 2 K.B. 223. But if the promise to perform an existing obligation by A to B is made by A to C, it is valuable consideration for any promise by C, because A imposes on himself a new obligation which can be enforced by the stranger C. The law in India is the same.

6. *Consideration must be legal* : otherwise the contract is void. It is considered *infra* under the head of legality of consideration and object.

### Consideration and Discharge of Contract.

In the case of reciprocal promises we have seen that the promise of the offeror forms the consideration for the promise of the offeree ; and so if subsequent to the agreement both parties agree that their respective promises may not be enforced, the subsequent agreement is valid and supported by consideration. The consideration in such cases consists of the promise of the offeree not to enforce the promise in his favour, in consideration of the offeror making a similar promise. But in the case of unilateral contracts with executed consideration, the rule in England is not so simple. According to English Law consideration is necessary not only for the formation of contracts but also for their discharge. Thus if in consideration of services rendered by B, A promises to pay £5 to B, subsequently B cannot waive or release his claim for £5 because the promise to waive is not supported by consideration. Therefore in England, even after a person makes a promise giving up his claim under a contract, he can enforce the original claim, unless the subsequent promise of waiver is supported by some consideration, be it a peppercorn or a piece of chalk. But if the release or waiver is contained in a formal contract or a speciality, the waiver is valid, because in the case of formal contracts consideration need not be present. This rule that a promise to release or give up a claim under a unilateral contract is not enforceable unless either reduced to a speciality or is supported by consideration, is known as the *doctrine of accord and satisfaction*. (Accord simply means agreement to waive.)

To this rule there are two limitations :—

(1) Accord executed is satisfaction but accord executory is not satisfaction. This exception simply means that if a person who is under an obligation to deliver a book delivers a pen instead, the original obligation cannot be enforced, because the accord or promise of waiver has been performed or executed. But instead of delivering the pen a promise is made to deliver it, the original promise to deliver the book remains subsisting, because the accord is only in an executory stage, and executory accord is not enforceable.



(2) The second limitation to the rule of accord and satisfaction is known as "The Rule in Pinnel's case." This limitation is to the effect that a part payment of a debt in cash can never amount to satisfaction of the whole debt. But if along with a certain amount of cash, or even without it, a thing of a different specie is delivered and accepted that would amount to satisfaction of the debt. In *Foakes v. Beer*, (1884) 9 A.C. 605, A obtained a decree against B for £2,090-19sh. with interest. B paid the said principal amount in instalments and it was received by A in full satisfaction. Subsequently A took out execution for the interest. Held that since the doctrine of consideration has been definitely extended to the discharge of contracts, the payment of a smaller sum would not amount to satisfaction of the entire sum due, as there was no consideration for the promise to remit the balance and the rule in Pinnel's case was approved.

In India, fortunately this technical rule of accord and satisfaction is not applied and S. 63 lays down as follows :

"Every promisee may dispense with or remit wholly, or in part, the performance of the promise made to him, or may extend the time for such performance and may accept, instead of it, any other satisfaction which he thinks fit."

Thus executory accord is perfectly valid in India and the rule in Pinnel's case has no application in our country.

*Note* :—It is needless to add that the rules regarding consideration are too artificial and do not stand the test of sound reason at all points. This was realised by Judges and Lawyers in England, and in 1934 a Committee was appointed for the purpose of reporting to the Lord High Chancellor, the amendments which they would propose to the various rules of consideration. The said Law Revision Committee of England was of opinion that the doctrine of consideration was a fossil of olden times which had overstayed, and recommended the abolition of most of the above rules. In particular the Committee was of opinion that consideration being only evidence of the intention of parties to create a binding obligation, a promise in writing, though neither under seal nor supported by consideration, should be enforceable, as has been held by Lord Mansfield in *Pillans v. Van Mierop* (supra). The recommendations of the Committee tend to upset the very foundations of the law relating to consideration, and if ever they should be accepted, the law would be much simplified.

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## CHAPTER VI

### CAPACITY OF PARTIES TO A CONTRACT

The age of majority, as well as a disqualification from contracting is to be determined by the law to which the contracting party is subject (law of domicile). But this is held not to be an inflexible rule. In the case of mercantile contracts *lex loci contractus* or the place where the contract is made would prevail, and in the case of contracts relating to land *lex situs* or the place where the land is situate would prevail.

A party's incapacity to enter into a contract may arise either on account of status, or on account of mental deficiency. While in the case of the former, the disability is imposed on grounds of political considerations and expediency, the disability in the case of the latter is imposed with a view to protect the interests of the person suffering that disability. Incapacity to enter into a contract may therefore be broadly classified under two headings :—

- (i) Incapacity arising from the status of an individual. This may be due to any of the following reasons :—
  - (a) Political or civic status, *e.g.*, where the person contracting is a Ruler of a Native State, or a foreign sovereign ; or an alien enemy ; or a convict or a bankrupt.
  - (b) Profession of the contracting person, *e.g.*, a barrister.
  - (c) Incorporation.
  - (d) Marriage.
- (ii) Incapacity arising from mental deficiency of the person contracting as in the case of (a) minors, (b) insane persons, (c) idiots and (d) drunken persons.

Incapacity arising from status :

(1) *Foreign sovereigns and Ambassadors*.—Foreign states, sovereigns, or governments can according to English Law enter into contracts, but cannot be sued upon them, unless they submit themselves to the jurisdiction of English Courts. In *Mighell v. Sultan of Johore*, (1894) 1 Q. B. 149, an English lady was promised to be married by a foreign sovereign travelling the country *incognito* and a suit filed by her on that contract was dismissed on the ground that British Courts could not enforce the contract

against him unless he voluntarily submitted to their jurisdiction. Ambassadors and their suites are in the same privileged position according to the Diplomatic privileges Act 1708. *Engelke v. Musmann* (1928) A. C. 433. In India, S. 84, Civil Procedure Code, lays down the procedure that has to be followed in suits against Foreign Sovereigns and Foreign Ambassadors. Though the freedom to enter into contract in British India by such persons has not been curtailed, a restriction is imposed on its enforceability, in that a suit on such a contract cannot be filed without the permission of the Governor-General in Council.

(2) *Alien Enemy*.—During ordinary times, the subject of a foreign country (alien) has got the right to enter into a contract with any British subject, but during war this power of an alien (who would then be an alien enemy) is denied. There cannot be a contract between a British subject and the subject of a country warring with Britain, unless the alien resides in England and has obtained permission to carry on trade ; because it is a well-established rule of law that declaration of war is a warning to all civil subjects not to carry on trade with the country at war. Whether a person is an alien enemy, or not, has to be determined by the place of residence of the individual during the time of war. If a British subject resides in an enemy country during war, he would be treated as an alien enemy, because by his being permitted to trade he will be enriching the enemy of his own country, which cannot be permitted. In *Porter v. Freudenberg*, (1915), 1 K. B. 857, it has been held that nationality is not the test of enemy status. If a contract was entered into between subjects of two countries before war was declared between them, its performance will be suspended during the continuance of the war, but if the period of war is fairly long, the contract would be void on the ground of impossibility of performance. The law is the same in India.

(3) *Felons and Convicts*.—Persons undergoing sentence cannot enter into contracts, nor can they sue in British Courts except when they have a licence called *ticket of leave*. Their capacity to enter into a contract, and to sue, is only suspended during the period of sentence and is regained after its expiry.

(4) *Bankrupts*.—On the adjudication of a person as a bankrupt or as an insolvent, his right to bind his estate by contracts entered into by him comes to an end, as his estate vests in the

Official Assignee or Official Receiver, as the case may be from the time of adjudication, who will be the only proper person entitled to deal with the insolvents' property, and to sue and be sued on his behalf.

(b) *Incapacity arising out of professional status.*—In England Barristers cannot enter into contracts with respect to the fee for their services, as they are supposed to be of a purely honorary character, but there is no such corresponding disability in India.

(c) *Artificial persons—Corporations.*—A corporation is an artificial person created by law. The chief feature of a corporation is that it has no physical existence, and can only act through human beings as agents who, so long as they act within the limitations of law, incur no personal obligations. The privileges which a corporation enjoys can be obtained by a special Act of the legislature or by registration under an Act, *e.g.*, the Companies Act. A corporation which is most familiar to us is a joint stock company registered under the Companies Act. Corporations have the right to sue and liability to be sued, and can enter into contracts, acquire properties, and contract debts, in short, do everything except acquiring certain rights and privileges which are only incidental to physical existence. The prominent features of a corporation are : (1) a perpetual existence, (2) a distinctive name and (3) a common seal. Corporations generally consist of more than one individual, when they are called *corporations aggregate*, *e.g.*, Municipalities, water-supply corporations, railway and trading companies, etc. A corporation may also consist of an individual when it is called a *corporation sole*, *e.g.*, King of England, Viceroy of India, a Bishop, etc.

The limitations to the power of a corporation to enter into a contract are as follows :

- (1) It cannot enter into contracts like contract to marry etc., because it has no physical existence.
- (2) Except a contract of minor importance or of daily occurrence, a contract entered into by a corporation must be under its seal.
- (3) A contract entered into by a corporation beyond the scope or object for which it is brought into existence is *ultra vires* and absolutely void. Even a ratification of such a contract by all the members of the corpora-

tion would not cure the defect. In *Ashbury Railway Carriage Co. v. Riche*, (1875) 7 H. L. 653, it was held that a railway company incorporated with the object of manufacturing and selling railway plant and rolling stock, could not enter into a contract through its directors for the purchase of a concession for constructing railway in Belgium, and that the ratification of the same by the entire body of the shareholders could not validate the contract.

- (4) A power to borrow, before it can be exercised by a corporation, must have been expressly or impliedly granted under the articles governing the corporation. Ordinarily speaking, all trading companies enjoy that privilege of borrowing, as it is a power necessary for carrying out their main object, *viz.*, trade.

(d) *Marriage*.—It may be interesting to note that in the civilised country of England, a married woman originally had a very serious disability in the matter of acquiring property and binding herself by contracts entered into during her coverture, for it was said that at common law a husband and wife were one in the eye of law, and that after marriage her property vested in her husband and she became incapable of acquiring or owning separate property or binding her property by contracts entered into by her. This disability terminated only when the married woman became a '*feme sole*' either by death of the husband, or divorce, or judicial separation. But the rigidity of this rule was diminished to some extent by the Married Women's Property Acts from 1882 to 1893, which, by introducing the doctrine of 'separate use' and transfer of property to her separate use with restraint upon anticipation, enabled married women to own separate property, and bind themselves by contracts. But all these Acts were superseded with respect to future marriages by the Law Reform (Married Women and Tortfeasors) Act, 1935. The present law in England governing married women is to this effect. A married woman can acquire and deal with property and incur obligations in contract as well as tort, and can sue and be sued, and be subject to the Bankruptcy law and enforcement of judgments and orders like an unmarried woman or for the matter of that any man. Further according to the above Act there is no such thing as old separate estate, and a married woman's property can be dealt with like a man's, and

any attempt to restrict that right, which restriction may not be annexed in the case of a man, is void.

In India even according to the ancient texts a Hindu married woman was entitled to enjoy and exercise absolute powers of disposal over her property, which is called *Stridhana*, and the disabilities of the married woman in England, never existed in our country.

A married woman in England as well as in India has got the right of binding her husband as his agent, with respect to necessities of the house-hold purchased on credit.

Incapacity arising from mental deficiency :

(a) *Infancy*.—An infant or a minor is a person who is not a major. A person attains majority on completing his 21st year in England, and 18th year in India. Even in our country if the property of a minor is under the management of the Court of Wards, or a guardian is appointed by Court for his person or property or both, he attains majority only on his completing the 21st year (Indian Majority Act, S. 3).

The Common Law of England as modified by the Infants' Relief Act of 1874, and the Sale of Goods Act of 1893 lays down the law relating to contracts entered into by a minor as follows :

- (i) Contracts are *valid* if they are—
  - (a) for necessities.
  - (b) for the minor's benefit.
- (ii) Contracts by minor which involve recurring rights and obligations, like partnership, holding shares in a company, and leases, are only voidable and not void. They cannot be enforced against him during infancy, but, unless the minor avoids them in a reasonable time after attaining majority they will be binding on him. *Edwards v. Carter* (1893) A. C. 360.
- (iii) (a) Contracts for money lent, or to be lent.
- (b) goods supplied or to be supplied,
- (c) accounts stated,
- are absolutely *void*.
- (iv) Contracts to purchase, or marry, prior to the Infants' Relief Act, were invalid until affirmed. Such

contracts after the Act are *void* and they cannot be ratified whether there is fresh consideration or not.

In India the law is stated in S. 11 as follows :—

“ Every person is competent to contract who is of the age of majority to which he is subject and who is of sound mind, and is not disqualified from contracting by any law to which he is subject ” and Sec. 12 of the Contract Act defines a “ sound mind ” as “ one which enables a person possessing it to understand a contract and form a rational judgment as to its effect upon his interest.”

It may be noted that the Act has not made it clear whether the contracts entered into by a minor and other persons incompetent to contract, are void or voidable. Till the decision of the Privy Council in *Mohori Bibee v. Dhurmodas Ghose*, 30 Cal. 539, the High Courts in India were not unanimous about the effect of a contract entered into by a minor, but that decision clearly laid down that all contracts entered into by a minor are void. It was accordingly held in that case that a mortgage by a minor was void, and the money lender was not entitled to repayment of money even according to Ss. 64 and 65 of the Act, on the decree declaring the mortgage to be invalid being passed. But it has been held in some cases that under Sec. 41 of the Specific Relief Act the Court may on adjudging a mortgage or other instrument as void according to the above principles, if satisfied that it was procured by the minor by fraudulent representation as to his age, exercise its discretion and direct the minor to make compensation to the other party *Vaikuntarama v. Authimoolam* 38 Mad. 1071; *Jagar Nath Singh v. Lalta Prasad*, 31 All. 21 ; The Allahabad High Court took a contrary view in *Ajudhia Prasad v. Chandam Lal* I. L. R. 1937 All 610 (F.B.). Therefore the general rule in India is that a contract entered into by a minor is absolutely void and incapable of being made valid even by ratification. *Arumugam v. Durasinga* 37 Mad. 38 and *Gobindram v. Piranditta* (1935) 16 Lah. 456 (F.B.). Where a contract is entered into on behalf of a minor by his guardian or manager of estate, the contract can be specifically enforced by or against the minor if (i) the contract is one within the competence of the guardian to enter so as to bind him and (ii) is for the benefit of the minor, but not otherwise. *Etwaria v. Chandranath*, (1906)

10 C.W.N. 763. But a guardian of a minor has no power to bind him by a contract for the purchase of immoveable property, and the minor is therefore equally not entitled to specific performance of such a contract. *Mir Sarwarajan v. Fakruddin Mahomed*, 39 Cal. 232 (P.C.).

S. 68 provides for liability of minors' estate in certain cases as follows :—

“If a person, incapable of entering into a contract, or any one whom he is legally bound to support is supplied by another person with necessities suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.”

The section therefore entitles a trader to *reimburse* himself to the extent of the supplies made by him of articles which are *necessaries* to the minor. It should therefore be noted that when the legislature empowers the trader to recover the value of the goods supplied by him, it is not validating a void contract but simply creating an obligation on the minor's estate to repay the value of the benefit received by the minor, on the basis of a quasi-contract. Hence it is that we called S. 68 a seeming exception (*supra*). For instance if a minor purchases goods on credit and executes a promissory note towards their value, the trader cannot on the strength of the note succeed in a Court of Law, because the promise of the minor contained in the note is void. But if the trader bases his claim on the consideration furnished by him, or in other words on the benefit received by the minor's estate, the Court will pass a decree to that extent on the basis of a quasi-contract.

Though S. 68 refers only to ‘necessaries’ supplied to a minor it is clear from the spirit of the Act and from the decisions of the High Courts that even in the case of contracts which are not for necessities but which are undoubtedly beneficial to the minor, an obligation is imposed on the minor's estate to reimburse the person who provided that benefit.

*What are necessities.*—“Necessaries” are defined in S. 2 of the Sale of Goods Act, 1893 (English Act) as

“Goods suitable to the condition in life of such an infant or minor or other person and to his actual requirements at the time of sale and delivery.”



Thus before certain articles can be classified as "necessaries" they should apart from belonging to a class of useful articles be (1) suitable to the position and financial status of the infant and (2) they must also be necessaries at the time of contract as well as delivery.

In *Ryder v. Wombwell*, (1868) L.R. 4 Ex. 32, it was held that a minor having an annual income for £ 500 and property worth 20 thousand pounds, could not bind his estate for the price of a golden goblet at £15, 15sh. given as a present to his friend, and the price of cuff-links at £25 for the personal use of the minor. The Court held that though the articles supplied belonged to a useful class, the question that had to be determined was whether they were necessary in the circumstances of that particular minor.

In *Nash v. Inman*, (1908) 2 K. B. 1, the Court held that an undergraduate of Oxford who was provided with necessary clothing before he joined the College could not be made liable for the price of 11 fancy waistcoats at 2 guineas each, supplied to him by a trader. The test applied was that apart from proving that the articles supplied suited the condition in life of the infant, the trader should also prove that the infant required that article at the time of supply; or in other words, the burden of proving that the infant was not already provided with the goods of the class, (namely necessaries) supplied by the trader, lay upon him and applying this test it was held that the 11 waistcoats were not necessaries.

In *Roberts v. Gray*, (1913), 1 K. B. 520, it was laid down that the liability of a minor to reimburse the trader applied not merely to absolute necessaries of life like bread, cheese and clothes, but to education and instruction and that if looking at the contract as a whole, it is for the minor's benefit, it should be enforced. It was held that a contract entered into by a minor to pay a certain sum of money to a noted billiards player John Roberts and to learn and play matches with him during his world tour, was beneficial to the minor, who wanted to become a professional billiards player, and that the contract could be enforced against the minor.

**Enforceability of a contract by minor.**—Though a contract entered into by a minor is void, it should not be supposed that where the minor is entitled to certain rights under the contract *e.g.*, Sale, mortgage, or promissory note he cannot enforce them. In *Raghavachari v. Srinivasa*, 40 Mad. 308 (F.B.) it was held that a mortgage in favour of a minor was valid and that he was entitled to enforce it.

**Infants' right to repudiate a contract which is performed.**—If a minor enters into a contract which is performed, will the Court enable the minor to get back the money paid by him? The answer is that if complete restitution is possible, *i.e.*, if the Court is able to place the parties in the positions they occupied before entering into the contract, the Court will compel the other party

to the contract to return the money to the infant, but not otherwise. Thus if A purchases a motor cycle for Rs. 1,000 and pays Rs. 500 in cash and executes a promissory note for the balance of Rs. 500 the minor cannot, after using the cycle for a sufficiently long time, claim to return the motor cycle and get back the sum of Rs. 500 paid by him and escape liability under the promissory note. In such a case the Court can only help the minor to the extent of exonerating him from liability under the promissory note. But if the minor after entering into the contract, but before taking delivery of the motor cycle, comes to Court and repudiates the contract, he can recover the money paid by him and the promissory note will be declared void, because in this case complete restitution is possible.

*Infants and estoppel* :—The law relating to estoppel is contained in S. 115 of the Indian Evidence Act which is as follows :—

“ When one person has by his declaration, act or omission intentionally caused or permitted another person to believe a thing to be true, and to act upon such belief, neither he nor his representative shall be allowed in any suit or proceeding between himself and such person, or his representative to deny the truth of that thing.”

Applying this rule, if a minor, falsely represents himself to be a major and enters into a contract with a trader, should he be estopped from contending in a suit between himself and the trader that he was not a major ? In England as well as in India the minors' interests are protected with zeal and special favour, and the general rule of estoppel has not been applied by Courts to such cases, on the ground that if the law were to be otherwise it would give a handle to dishonest traders to obtain false declaration in writing from the infant that he is a major at the time of contracting.

In *Sadiq Ali Khan v. Jaikishore*, A.I.R. (1928) P.C. 152, the Privy Council held that a deed executed by a minor is a nullity and incapable of founding a plea of estoppel, on the ground that there can be no estoppel against statute which has declared minors contracts to be void.

*Infants and Restitution* :—“ Infants can have no privilege to cheat men,” observed a learned Judge, and the law is that if a minor has obtained property by cheating or by practising fraud, he will be compelled to restore the property to the original owner,

Thus if a minor fraudulently overstates his age and takes delivery of a motor car after executing a promissory note in favour of the trader for its price, we have already seen that the minor is not estopped from pleading minority and can escape liability under the promissory note. But so far as the trader is concerned, the Court on equitable considerations will order restitution, *i.e.*, compel the minor to return to the trader the car or any article which he took from him, or the property into which it has been converted.

But if the car cannot be traced, or is destroyed, can the trader request the Court to pass a decree against the minor for the price of the car? The answer is in the negative. *Stocks v. Wilson*, (1913) 2 K. B. 235 and *Leslie v. Sheill*, (1914) 3 K. B. 607, where Lord Sumner observed "Restitution stopped when repayment began."

*Infant's liability for torts* :—An infant does not enjoy any immunity from liability for torts committed. *Burnard v. Haggis*, (1863) 32 L. J. C. P. 189. But an infant cannot be made liable for what is in truth a breach of contract by framing the action *ex delicto*. "You cannot convert a contract into a tort to enable you to sue an infant." *Jennings v. Rundall*, (1799) 8 T.R. 335. *Leslie v. Sheill* Supra.

(b) *Lunatics*, (c) *Idiots* and (d) *Drunken Persons* :—S. 12 of the Contract Act is very wide in its definition of the words "unsound mind" and therefore lunatics cannot enter into contracts, except during their lucid intervals. Similarly persons who are dead drunk or who are congenital idiots not possessing even a ray of thinking power, cannot enter into contracts. All these persons stand on the same footing as minors, and their contracts are void according to Indian Law.

According to English law a contract entered into by a lunatic or a drunken person is only voidable, and the person who seeks to avoid the contract on the ground of insanity or drunkenness must not only prove his incapacity, but should also prove that the plaintiff was aware of it. *Imperial Loan Company v. Stone*, (1892) 1 Q. B. 599. But the Indian Law as already stated is different from the English Law.

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## CHAPTER VII

### FLAW IN CONSENT—MISTAKE

As already stated, not only should the parties to a contract have identity of minds but the consent of the parties must also be real and free, *i.e.*, if one of the parties is under any misapprehension due to (1) mistake or (2) misrepresentation or (3) duress or coercion or (4) undue influence, the contract will not be enforced.

S. 10 lays down that "All agreements are contracts if they are made by the free *consent* of parties———";

and S. 13 : enacts ; "Two or more persons are said to consent when they agree upon the same thing in the same sense";

and S. 14 defines 'free consent' thus : "Consent is said to be free when it is not caused by

1. Coercion as defined in S. 15, or
2. Undue influence as defined in S. 16, or
3. Fraud as defined in S. 17, or
4. Misrepresentation as defined in S. 18, or
5. Mistake subject to the provisions of Ss. 20, 21 and 22.

Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake." Thus the Indian Law makes it clear that if any of the invalidating elements exist, there is flaw in consent.

Thus a flaw in consent may be due to any of the following causes :—

(i) Mistake, which may relate to (a) Fact or (b) Law.

Mistake of fact may in its turn relate to the (1) Subject-matter of the contract, *e.g.*, regarding its existence, quality, identity or quantity, etc. (2) Nature of the contract (3) Person entering into the contract.

Mistake of law may be regarding (a) Foreign Law or (b) Ordinary Law or Law of our country or (c) Private rights of

the contracting parties. Another classification of mistake is into (a) Unilateral and (b) Bilateral.

(ii) Misrepresentation : It may be (a) Innocent or (b) Fraudulent.

(iii) Coercion.

(iv) Undue Influence.

Sir John Salmond groups cases of flaw in consent under two headings (1) *Error in consensu i.e.*, error in the very consenting mind. This error is the result of mistake. (2) *Error in causa i.e.*, error in the inducing cause. This error may result from coercion, fraud, undue influence or misrepresentation. Thus if A signs a promissory note in favour of B on his representing that A is signing as a witness on a receipt, though there is the outward semblance of consensus, there is really no consent at all. In this case, the flaw in consent tantamounts to absence of consent, because if A had known the truth, he would not have signed at all. In such cases where the consent is totally absent in the eye of law, due to mistake, the contract is void. This error in consent is called '*error in consensu*'.

In the very same illustration if A is made to sign the promissory note under a threat of being shot dead by B if he (A) refused to sign, A cannot say that he did not know what he was signing. He can only complain that left to himself he would not have executed the promissory note. This is not a case of total absence of consent but is a case of an error in the cause that induced him to sign. This error is called an *error in causa*. In such cases the contract is only *voidable*.

In practice it is not very easy to draw the line between '*error in consensu*' and '*error in causa*,' because a mistake in the mind of one party to a contract may often be caused by fraud practised by the other ; in other words, an *error in consensu* and an *error in causa* may exist together. In such cases the contract is void and not simply voidable.

*Mistake*.—Mistake may be of two kinds:—(i) Mistake of fact; (ii) Mistake of Law.

Mistake of fact may be either (i) Mistake of both the parties or (ii) Mistake of only one party.

*Mistake of both parties—Mistake of fact*:—A mistake of fact in the minds of both the parties, also called *mutual mistake*,

negatives *consensus-ad-idem* and the contract in such cases is void. Section 20 reads thus: "Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void".

It applies only if the mistake is a mistake in the consenting minds, and not a mistake in the expression of the consent. If a mistake is committed in reducing the contract to writing it is called *error in verbis* and it gives a right to rectify the contract in accordance with the agreement of the parties, but does not render the contract void. Another requisite of Sec. 20 is that the mistake must relate to some essential matter, like the following :

(a) *Mistake as to existence of subject-matter* :—In *Scott v. Coulson*, (1903) 2 Ch. 249, a contract for the sale of a policy of life assurance was set aside on the ground that at the time of entering into the contract both the vendor and the purchaser believed that the assured was alive, while as a matter of fact he was dead. In *Couturier v. Hastie*, (1856) 10 E. R. 1065, two persons entered into a contract for the sale and purchase of Indian corn supposed to be on board a particular ship bound for England. Unknown to both parties the corn was damaged and discharged at an intermediate port, some days prior to the contract. Held the contract was vitiated by mistake.

(b) *Mistake as to identity of the subject-matter* :—In *Raffles v. Wichelhaus*, (1864) 2 H. & C. 906 a contract was entered into for the purchase of 125 bales of cotton to arrive by a ship called 'Peerless' from Bombay. Two ships of the same name were to sail from Bombay, one in October and the other in December. The vendor intended to send the goods by 'Peerless' sailing in December while the purchaser intended to receive them by 'Peerless' sailing in October. In a suit by the vendor, held that the parties were under a mistake as to the identity of the subject-matter and that there was no contract.

*Mistake of one party or unilateral mistake*.—In the case of unilateral mistake, i.e., where only one party to a contract is under a mistake, the contract generally speaking is not invalid. Sec. 22 reads thus : "A contract is not voidable merely because it was caused by one of the parties to it being under a mistake as to a matter of fact."

But to this rule there are the following exceptions :—

(1) *Where the unilateral mistake is as to the nature of the contract.*—In *Foster v. Mackinnon*, (1869) L. R. 4 C. P. 704, an old illiterate man was made to sign a bill of exchange, by means of a false representation that it was a guarantee. When a suit was filed by the endorsee of the bill the Court observed —“that he never intended to sign and therefore in contemplation of law never did sign the contract to which his name is appended.” It was therefore held that though the signature was obtained by fraud it was a case of error *in consensu* and the contract was void. It should be noted, however, that in the case of negotiable instruments the person pleading mistake as to the nature of the contract should not only prove the mistake, but should also prove that there was no negligence on his part. In the above case the jury found that the old man was not negligent in signing. A similar principle was laid down in *Carlisle and Cumberland Banking Corporation v. Bragg*, (1911) 1 K. B. 489. It should also be noted that this plea of mistake will be available only when it relates to the nature of the contract and not to the terms of the contract. *Blay v. Pollard and Morris* (1930) 1 K. B. 628.

(2) *Mistake as to the identity of the party contracted with:* Where X intends to contract only with A, but enters into a contract with B, believing him to be A, the contract is vitiated by mistake, as there is no *consensus-ad-idem*. *Boulton v. Jones* (1857) 2 H. & N. 564.

In *Cundy v. Lindsay*, (1878) 3 A. C. 459. one Blenkarn by imitating the signature of a reputed firm Blenkiran induced X to supply him with goods on credit, which he sold to C. In a suit by X against C for recovery of the goods: held that as X never intended to contract with Blenkarn there was no contract between them, and consequently even the innocent purchaser C from Blenkarn did not get a good title, and was liable.

In *Phillips v. Brooks*, (1919) 2 K. B. 243, a fraudulent person N entered a jeweller's shop and selected certain jewels, which the jeweller was prepared to sell him individually as a casual customer. N drew and signed a cheque pretending to be one G a gentleman with credit. N was allowed to take away the jewels in exchange for that cheque. Held that there was no mistake as to identity of the person and hence the contract was not void, but that it was vitiated only by fraud and hence voidable.

This case should be contrasted with *Lake v. Simmons*, (1927) A. C. 487, where a lady A induced B to deliver possession of two

pearl necklets falsely representing that she was the wife of a Baron C, and that she wanted them for obtaining his approval before his purchasing them. In this case it was held that B intended to deal only with C, the alleged husband of A, and not with A herself. The mistake related to the identity of the individual and it was held that the contract was void and that A could not convey any title even to *bona fide* purchasers.

### (3) *Mistake as to quality of promise :*

Where a party to a contract is under a mistake as to the quality of the promise which the seller is making, and not as to the subject-matter of the contract, the contract is void. Mistake as to quality of the subject-matter of contract must be distinguished from mistake as to quality of the promise.

No one can complain that he was under a mistake as to the quality of the subject-matter of the contract, because the law does not cast a duty upon the seller to point out defects in the goods he is selling; the maxim is *caveat emptor*,—let the purchaser beware.

In *Smith v. Hughes*, (1871) L. R. 6 Q. B. 597, A sold oats to B by sample and B thinking that they were old oats purchased them while in fact they were new oats. It was held that B was bound by the contract, as the parties had in mind the identical oats at the time of entering into the contract.

But to this rule there is only one exception in the case of contracts '*uberrimae fidei*' i.e., contracts of utmost good faith. The most familiar type of such contract is a contract of insurance, where the assured has to make a frank disclosure of all facts known to him and essential for the purpose of enabling the other party to give a free consent.

Where however the mistake complained of is a mistake as to quality of the promise made, the contract is void.

In *Scriven v. Hindley*, (1913) 3 K. B. 564, A held an auction for the sale of some lots containing hemp, and some containing tow. B came to purchase hemp only, which fact was known to A. B thinking that hemp was being sold, bid for a lot of tow, for an amount which was out of proportion to it, and was only a fair price for hemp. It was held that B was not estopped from proving that he was mistaken as to the quality of the promise made by B with reference to the goods sold, and that the rule of *caveat emptor* did not apply. In these cases according to Sir William



Anson, the mistake is by one party as to the intention of the other known to that other, and not a unilateral mistake regarding the quality of the articles sold.

Where the contract made was the one intended, but it is different from the contract which one of the parties would have made, if he was aware of all the facts, the contract is not void on the ground of mistake. *Bell v. Lever Bros. Ltd.*, (1932) A. C. 161.

*Mistake of Law* :—Mistake of Law may be of three kinds : (1) mistake of the law of the land, (2) mistake of a foreign law, and (3) mistake of rights of private individuals, which are mixed questions of law and fact. The effect of mistake of law on a contract is expressed by the maxim '*Ignorantia juris non excusat*,' i.e., ignorance of law is no excuse. This principle is certainly based on common sense, for if the rule were otherwise it will be impossible to administer the law. But this maxim applies only to the law of the country and not to foreign law. If a person pleads ignorance of foreign law, it will have the same effect as mistake of fact. The Indian Law on this point is contained in Sec. 21 which reads thus : "A contract is not voidable because it was caused by mistake as to any law in force in British India ; but a mistake as to a law not in force in British India has the same effect as a mistake of fact."

In the case of private rights which are mixed questions of law and fact, a mistake concerning them has the same effect as a mistake of fact. In *Cooper v. Phibbs*, (1867) L.R. 2 H.L. 149, A in ignorance of his own rights took a lease of certain fishery rights belonging to him (A) from B, thinking that they were B's. Held that ignorance of a private right had the same effect as ignorance of fact, and therefore was a ground for avoiding the contract.

*Remedies in cases of mistake*.—As mistake renders a contract void, if the contract is still executory i. e., yet to be performed,, the party complaining of the mistake may repudiate it, and also resist an action for its specific performance. If the contract is executed, the other party who received any advantage under the contract will, under Sec. 65 of the Contract Act, be compelled to restore it or to make compensation for it, as soon as the contract is discovered to be void.

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## CHAPTER VIII

### FLAW IN CONSENT—MISREPRESENTATION

A party may give his consent to a contract on account of some false statement made by the other party to it, but for which the former might not have entered into the contract. These false statements or misrepresentations may be either the inducing cause of the contract, or may be embodied in it, so as to form the terms of the contract. A misrepresentation may be either (i) innocent or invalidating, or (ii) fraudulent or actionable. Terms in a contract may be either (a) *conditions* or (b) *warranties*. If a false representation relates to a condition, the party complaining can either rescind the contract, or claim damages, but if it relates to a warranty he can only claim damages.

Whether a term is a condition or a warranty is a question of intention of the parties (Sec. 12 Sale of Goods Act).

#### Innocent misrepresentation

A representation was defined by Williams, J. as : "a statement or assertion made by one party to the other before or at the time of the contract of some matter or circumstances relating to it."

Sec. 18 of the Contract Act defines 'misrepresentation' as follows:

"Misrepresentation means and includes:—

- (1) The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;
- (2) Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, by misleading another to his prejudice or to the prejudice of any one claiming under him;
- (3) Causing, however innocently, a party to an agreement to make a mistake as to the substance of a thing which is the subject of the agreement."

Thus the essential ingredients of innocent misrepresentation are:—

- (i) there should be a representation or assertion; or a breach of duty or a failure to make a disclosure in contracts '*uberrimae fidei*.'
- (ii) Such representation or non-disclosure must relate to a fact and not to an opinion;
- (iii) Such representation must have become untrue; and
- (iv) Such representation must have been material in influencing the other party to enter into the contract.

According to the section, it is clear that it does not deal with terms which form part of a contract as conditions or warranties, but only with representations which induce the party to enter into a contract. The difference between the two is material because while a breach of the representations which induce a contract affects its formation, a breach of the conditions or warranties affects its performance. A contract which is vitiated by innocent misrepresentation is voidable.

Even if a representation is true when made, but becomes untrue to the knowledge of the person making it, before the contract is entered into, it would unless corrected, render the contract voidable. *With v. O'Flanagan* (1936) 1 Ch. 575.

As a general rule representations which do not constitute the terms of the contract will not have any effect on its validity unless they are fraudulent. To this rule, however, there is one exception. illustrated in *Bannerman v. White*, (1861) 142 E. R. 685, A entered into a contract with B for the sale of hops. A made a representation that no sulphur had been used in their growth and B made it clear to A that he would not purchase them if any sulphur was used for their growth. As a matter of fact, sulphur had been used in five out of 300 acres, which fact was evidently forgotten by A when he represented that no sulphur was used. This representation however did not form a term in the contract. It was held that the undertaking that no sulphur had been used was in the nature of a preliminary stipulation, and in a sense a condition, without which the contract would not have been proceeded with, and therefore the contract could be avoided, though the representation was not fraudulent.

### Fraud or Wilful or Actionable Misrepresentation

**Definition :—**When a misrepresentation is made by a party with a full knowledge that it is not true, or without belief in its truth, or recklessly, not caring whether it is true or false, it is said to be fraudulent.

Section 17 defines fraud thus :

“Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance or by his agent, with intent to deceive another party thereto or his agent or to induce him to enter into the contract :—

- (1) the suggestion as to a fact, of that which is not true by one who does not believe it to be true;
- (2) the active concealment of a fact by one having knowledge or belief of the fact;
- (3) a promise made without any intention of performing it;
- (4) any other act fitted to deceive;
- (5) any such act or omission as the law specially declares to be fraudulent.

**Explanation:—**Mere silence as to facts likely to affect the willingness of a person to enter into a contract, is not fraud, unless the circumstances of the case were such regard being had to them it is the duty of the person keeping silent to speak, or unless his silence in itself is equivalent to speech.”

The essential elements of fraud are :

- (1) There must be a representation or assertion or active concealment by a person or his agent.
- (2) It must relate to a fact, and not opinion or intention.
- (3) It must have been made with the knowledge of its falsehood, or without belief in its truth, or recklessly or carelessly whether it be true or false.
- (4) It must have been made with a view to induce the other party to act upon the assertion. *Peek v. Gurney* (1873) L. R. 6 H. L. 377.
- (5) The other party must have acted upon that representation, and must have been misled and damnified. *Horsfall v. Thomas* (1862) 1 H. & C. 90.

Comparing the essentials of innocent misrepresentation and fraud it will be noticed that it is only the third element relating to the mental condition of the person making the representation that distinguishes the two.

Sec. 17 places a person suppressing truth which, if stated, would make that which is stated false, on the same footing as a person making a false statement. In other words, a person guilty of '*suppressio veri*' (i.e., suppression of truth) is on the same footing as one making '*suggestio falsi*' (i.e., false suggestion.) Similarly 'active concealment' or 'aggressive concealment' sometimes amounts to fraud. For instance, if a person intending to sell certain wooden furniture takes the trouble of covering the several holes in it, and also gives a thick paint with a view to prevent their being detected by the prospective purchaser, the seller will be guilty of fraud.

A person may make a representation having any one of the following five mental states:—

- (1) Representation made believing it to be true, and on reasonable and sufficient grounds.
- (2) Representation made believing it to be true, but not based on proper grounds.
- (3) Representation made recklessly without any regard for its truth or falsity.
- (4) Representation made with the knowledge that it is false but without intention to deceive.
- (5) Representation made with perfect knowledge of its falsehood and with a view to deceive.

A person making representations falling under categories 4 & 5 is undoubtedly guilty of fraud. A representation coming under 3 presented some difficulty, but in the famous case of *Derry v. Peek*, (1889) 14 A.C. 337, the House of Lords held that even in such a case the individual who makes that representation will be guilty of fraud, because he feels a doubt and yet represents as if he is certain about the truth of his assertion, and "It is not the less false because the affirmation he makes is an affirmation about the state of his own mind."

Till the decision in *Derry v. Peek*, a person making a representation falling under 2 above, i.e., with an honest belief in its

truth but not based on sufficient grounds, was also held to be guilty of fraud, and it was called 'legal fraud' or 'fraud in Law'. But this view was rejected in the said case by the House of Lords.

In *Derry v. Peek* (1889) 14 A.C. 337 the directors of a Tramway Co. issued a prospectus stating that they had the right to run tram cars with steam power and not with horses as before. In fact the Act incorporating the company provided that such power might be used with the sanction of the Board of Trade. The directors who got their plans previously approved by the Board of Trade thought that the permission required of the Board was a matter of course, and issued the prospectus as stated above. On the faith of that prospectus, the plaintiff took shares. Subsequently the Board refused to give permission and the company had to be wound up. Plaintiff sued the directors for damages for fraud. It was contended that inasmuch as the directors had not sufficient grounds for believing that permission would be granted, their representation, though honestly believed by them, would amount to fraud in law. This contention was accepted by the Court of appeal, but it was rejected by the House of Lords, who held that in order that fraud should be established moral fraud must be proved, and that legal fraud was as meaningless as legal heat or legal cold. This case finally established that a party guilty of misrepresentation which he believes to be true but not based on proper grounds, is not guilty of fraud, but only of innocent misrepresentation.

It need hardly be pointed out that a person making a representation with the mental state falling under 1 above would be guilty of innocent misrepresentation.

A contract vitiated by fraud is voidable.

*Remedies available in cases of fraud and misrepresentation:—*

(1) Fraud, or wilful misrepresentation gives rise to an independent action in tort (Civil wrong) entitling the aggrieved person to claim damages; but innocent misrepresentation does not give rise to a claim for damages, except in the three following cases:—

(a) *Breach of warranty of authority of an agent.*—Where an agent in good faith believes that he has the authority of his principal to represent him, while he has really no such authority, the agent is liable in damages, even though he is only guilty of innocent misrepresentation. *Collen v. Wright* (1851) 18 E. & B. 647.

(b) *Mis-statements in prospectus, etc.*—The directors of a company are liable in damages under Sec. 100 of the Indian Companies Act for innocent misrepresentations made in the prospectus, and certain other documents of

the company. This was added by the Legislature after the decision in *Derry v. Peek*.

- (c) Negligent representation made, by one person to another, between whom confidential relationship like that of solicitor and client etc. exists. *Nocton v. Ashburton*, (1914) A. C. 932.

(2) In the case of fraud as well as innocent misrepresentation the contract is voidable, and the aggrieved party can rescind the contract on the ground of absence of free consent. But the remedy of rescission will not be granted unless restitution is possible. The party asking for rescission should therefore come to the Court at the earliest possible moment and before the rights of third parties intervene. The Courts however do not view delay with strictness where the party could not discover the fraud earlier, provided the rights of third parties have not intervened.

(3) In both the cases a suit for the equitable remedy of specific performance can be successfully resisted by the aggrieved party.

(4) The party aggrieved can in each case defend an action against him for damages for breach of contract.

(5) In both cases, since the contract is only voidable, the party aggrieved can, if he so chooses, affirm the contract and enforce it against the other party. But once the contract is ratified, he cannot subsequently ask for rescission (S. 19 of the Contract Act).



## CHAPTER IX

### FLAW IN CONSENT—COERCION AND UNDUE INFLUENCE

A contract entered into under coercion or undue influence is voidable at the option of the party coerced or influenced. Duress or menace in English Law corresponds to coercion in Indian Law. *Definition*:—Coercion is defined in Sec. 15 as : “the committing, or threatening to commit, any act forbidden by the Indian Penal Code or unlawfully detaining, or threatening to detain, any property to the prejudice of any person whatever, with the intention of causing any person to enter into any agreement.” It is not necessary that the Indian Penal Code should be in force at the place where coercion is employed.

Duress is defined as causing or threatening to cause bodily violence or imprisonment with a view to obtain the consent of the other party to the contract. In England “duress” as an invalidating element in the law of contracts has become obsolete, on account of the growth of equitable jurisdiction under the head of undue influence, Coercion in Indian law has much wider amplitude than duress. One significant point of difference between English and Indian Law is that the doing of any act forbidden by the Indian Penal Code amounts to coercion, while duress is confined only to bodily violence and imprisonment. In *Ranganayakamma v. Alwar Chetty*, (1889) 13 Mad. 214, the refusal by the relatives of a deceased person to permit the cremation of his body, until his wife gave consent for adopting a boy, was held to amount to coercion.

The points of difference between duress and coercion are as follows:—

#### COERCION

1. It can be employed against any person including a stranger.
2. Unlawful detention of goods is coercion.

#### DURESS

1. It can be employed only against the life or liberty of the other party to the contract, or the members of his family.
2. Unlawful detention of goods is not duress.



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| <p>3. Coercion may be employed by any person and not necessarily the person trying to obtain the benefit of the contract.</p> <p>4. Coercion need not cause immediate violence.</p> <p>5. It need not be such as to affect a man with ordinary strength of mind.</p> | <p>3. It may be employed only by the party to the contract or his agent.</p> <p>4. It must be such as to cause immediate violence.</p> <p>5. It must be such as to affect a man with ordinary strength of mind.</p> |
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### Undue Influence

Undue influence is also called *constructive fraud*, and it is used to cover all cases where one party to the contract has not been fairly dealt with by the other. It consists in the improper exercise of a power over the mind of one of the contracting parties by the other, and in certain cases it is presumed, *e. g.*, where a young person enters into a contract with his parents. It renders the contract voidable. According to Sec. 16 a contract is said to be exercised by undue influence where :

1. The parties are so related, that one of them is in a position to dominate the will of the other ; and
2. That position has been used for obtaining an unfair advantage over the other.
3. A person is deemed to be in a position to dominate the will of the other where ;
  - (a) there is real or apparent authority over the other, or
  - (b) he stands in a fiduciary relationship to the other, or
  - (c) he makes a contract with a person suffering from old age or mental or bodily illness.
4. Where it is proved that such domination of the will prevailed and the transaction also appears to be unconscionable, the burden of proving that such contract is not obtained by undue influence lies upon the person who has got control over the other,

The following relationships are said to raise a presumption of undue influence :—

- |                              |                                    |
|------------------------------|------------------------------------|
| (1) Parent and child.        | (4) Spiritual master and disciple. |
| (2) Guardian and ward.       |                                    |
| (3) Trustee and beneficiary. | (5) Lawyer and client.             |
|                              | (6) Doctor and patient.            |

The leading case on the subject is *Allcard v. Skinner*, (1889) 36 Ch. D. 1452. Miss A joined a sisterhood and was under the spiritual subordination of the defendant for some time, during which period she gave away a bulk of her properties to the sisterhood. About 6 years after leaving the sisterhood, she sued for recovery of these properties. It was held that though the relationship between herself and the defendant raised a presumption of undue influence, her conduct, in keeping quiet for a period of 6 years after any such influence ceased to exist amounted to an affirmation of the gift made by her, and that she could not therefore recover the properties.

In *Jean Mackenzie v. Royal Bank of Canada*, (1934) P. C. 210 the Privy Council held that (a) there is no presumption of undue influence between husband and wife and (b) in cases where it is necessary to disprove the presumption of undue influence it should be proved that the 'protected person' had independent advice before entering into the transaction, and not subsequently.

In the recent case of *Palanivelu Mudaliar v. Neelavathi Ammal*, (1937) 1 M.L.J. 719 (P.C.), two sisters who were orphans and who were under the protection of their brother-in-law (sister's husband) executed a promissory note in his favour immediately after attaining majority, and in a suit on the note the Court held that the case came within the scope of Sec. 16 of the Contract Act, and that the payee ought to prove the good faith of the transaction.

Though the presumption of undue influence can be easily established in the case of parent and infant child, solicitor and client etc., it may also arise where the circumstances are such that influence can fairly be inferred. Thus where an illiterate wife who could only sign, mortgaged her entire property in favour of a creditor, in obedience to her husband's wishes, for an advance of a loan to her husband, who was at the end of his own resources, and who had been in management of the wife's properties, it was held that the wife was not a free agent, and the creditor who had notice of all the facts which raised the presumption of undue influence was in no better position than the husband, who

exercised it, and that the creditor could not therefore enforce the mortgage. *Tungabai etc. Kumbhojkar v. Yeshwant Dinkar Jog and another* (1944) 2 M. L. J. 350 (P.C.)

It may be noted that as between persons engaged to marry the presumption of undue influence has been drawn. *Bomeze v. Bomeze* (1931) 1 Ch. 289.

The most effective way of rebutting the presumption of undue influence arising from the fiduciary relationship between the parties, is to show that the party said to have been influenced had independent advice of a legal adviser, who had full knowledge of the relevant facts, *Inche Noriah v. Shaik Allie Bin Omar*, (1929) A. C. 127.

It may be noted that under Sec. 16, Courts can reduce the rate of interest stipulated in a contract, if the contract is unconscionable and is the result of undue influence exercised by the creditor on the borrower.

Sec. 19-A renders a contract vitiated by undue influence voidable, and the Court, while setting aside such a contract, may impose on the person claiming to avoid it reasonable and just terms.

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## CHAPTER X

### LEGALITY OF CONSIDERATION AND OBJECT

Having considered so far the several elements necessary for the formation of a contract, the next thing to be considered is the legality of the consideration or the object of a contract. Unless the consideration as well as the object are lawful, the contract is void.

Section 23 of the Contract Act lays down :

“The consideration or object of an agreement is lawful, unless it is forbidden by law, or, is of such a nature that, if permitted, would defeat the provision of any law: or, is fraudulent, or involves or implies injury to the person or property of another or, the Court regards it as immoral or opposed to public policy. In such cases the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.”

It may be noted that though the section attempts to enumerate the various kinds of unlawful agreements it has not been done satisfactorily. Unlawful agreements may be classified as follows :

- (i) *Illegal, i.e.*, where the agreement is contrary to Statute Law or Common Law.
- (ii) *Immoral, i.e.*, where it is opposed to public morals, *e.g.*, agreements for illicit cohabitation or for separation between husband and wife.
- (iii) *Opposed to Public Policy, i.e.*, where the agreement is forbidden as conflicting with the well-being of the state, *e. g.*, (1) agreements for sale of public offices and use of corrupt influence, (2) agreements which contemplate stifling of prosecution, (3) agreements tending to the abuse of legal process, (4) agreements in restraint of parental rights, (5) agreements in restraint of marriage and (6) agreements in restraint of trade,

**Illegal and unlawful agreements:**—It can be seen from the above classification that every illegal agreement is unlawful but the reverse is not true. The distinction between illegal and unlawful consideration is very important, because an illegal consideration renders not only the transaction between the immediate parties void, but it also renders collateral transactions void. An unlawful consideration on the other hand simply renders the transaction between the immediate parties void, but it has no effect on collateral transactions. If A borrows Rs. 100 from B for contracting with C for illicit manufacture of bombs, then the question whether B can recover that money from A depends on whether B was aware of the purpose for which the money was borrowed. If it is known to B, though the agreement between A and B is apparently lawful, its object being unlawful it is void. In other words the agreement between B and C has for its consideration the manufacture of bombs which is illegal, and so not only the agreement between the immediate parties B and C, but also the collateral agreement between A and B is rendered void, when the illegal purpose is known to B. On the other hand, if in the above illustration, the money was borrowed by A for the purpose of betting with C, the transaction between B and C is simply unlawful but not illegal. It therefore renders only the agreement between B and C void, but will not render the collateral transaction between A and B void, even if B was aware of the purpose for which the money was borrowed.

Acts which are opposed to public morals, or constitute crimes, are declared illegal, and the Courts will refuse to enforce any contract directly or indirectly connected with that illegal transaction. But where the transaction is simply one disapproved by law, on some ground of public policy, but which does not affect public morals or amount to a crime, the courts will simply declare it unlawful but not illegal.

In *Chava Ramu Nayudu v. Suryadevara Sektaramayya*, 58 Mad. 727 (F.B.) the defendant in the suit who was the highest bidder at an Abkari auction entered into a partnership with the plaintiff for carrying on the toddy shop business jointly. According to Cl. (27) of the General Sales Notification issued under the Abkari Act, sanction had to be obtained from the Collector by the highest bidder, in whose favour the licence is issued, for carrying on the business in partnership with another, and a violation of that rule is made punishable. No such licence was obtained in the present case, and the plaintiff who advanced money to the said partnership on a promissory note, instituted

the suit for its recovery. It was held by the Full Bench of the Madras High Court that the partnership was illegal and that consequently the money advanced for enabling such business to be carried on, with the knowledge that it was illegal, could not be recovered, and the suit was dismissed.

In *Italia v. Cowasjee and others*, (1944) 1 M.L.J. 97, A and B entered into a partnership to carry on toddy business, and afterwards a licence was obtained by one of them. A and B applied to the Collector to issue a licence in favour of the firm but it was refused. Held: the business carried on by the firm subsequent to the said refusal was unlawful, and a suit for accounts did not lie.

### Agreements forbidden by Law

Where an agreement is forbidden either by the Statute Law or by the Common Law, the effect of such prohibition may be to render that agreement unlawful or illegal. Whether in a particular case the agreement which is forbidden is illegal or unlawful will depend upon the construction of that particular provision of law, as already stated above.

*Wagering contracts.*—A wagering contract has been defined by Cockburn, C.J., thus: "A contract by A to pay money to B on the happening of a given event in consideration of B's promise to pay money to A on the event not happening."

It is defined by Sir William Anson as "A promise to give money or money's worth upon the determination or ascertainment of an uncertain event." The essence of a wager or bet is that both parties agree that they will pay and receive respectively, on the happening of an event, in which they have no material interest.

Thus A and B may wager regarding an uncertain event, whether it would rain on a particular day or not. A promising to pay Rs. 10 to B if it rained, and B promising Rs. 10 to A if it did not. There may also be a wager about an event which is certain, but regarding which there is uncertainty in the minds of the contracting parties *e.g.*, the height of the light house at Vizagapatam.

In England the law relating to gaming and wagering contracts is contained in the Gaming Acts of 1835, 1845 and 1892. The Act of 1835 declared wagers or games relating to sports illegal, while the Act of 1845 declared all kinds of wagers or games null and void. The Act of 1892 further declared that monies paid under, or in respect of wagering contracts dealt with by the Act

of 1845 not recoverable, and no commission or reward in respect of wager could be claimed in a Court of Law by agents employed to bet on behalf of the principal.

The Indian Law is simple and is contained in Sec. 30 of the Contract Act and it lays down that all agreements by way of wager are void, and that no one can recover the amount promised under such a contract either from the other party to the contract or the stakeholder. The only exception to this rule is provided in the case of a plate of the value of above Rs. 500 to be awarded to the winner in a horse race.

Thus in India unless the wager amounts to a lottery which is a crime according to Sec. 294-A of the Indian Penal Code, it is not illegal but simply void, and therefore the collateral transactions are not tainted. So persons who discharge wagering losses of an individual on his request, and an agent employed for the purpose of betting can recover the monies due to them in a Court of Law in India, but not in England.

In the recent case of *Muthuswamy Pillai v. Veeraswamy Pillai*, (1936) 70 M.L.J. 433, plaintiff and defendant went to horse races and each put an equal sum of money on the same horse which won, and the defendant in whose name the bet was made, collected the winnings but did not pay the half share of the plaintiff. It was held that the defendant received the half share of the plaintiff for the benefit of the plaintiff and that Sec. 30 of the Indian Contract Act is no bar to a suit by the plaintiff for recovery of his half share with reasonable rate of interest.

In *Sesha Iyer v. Krishna Aiyar*, 50 Mad. 562 (F.B.) it was held the Kuri or prize chit fund amounted to a lottery and hence illegal.

**Insurance Contract.**—According to Sir William Anson a contract of Insurance is a wager which is nevertheless enforced in a Court of Law. His argument was that in contracts of Insurance, the subject-matter was always an uncertain future event and each party stood to gain or lose, according as the event, happening one way or the other. But Porter and others opine that a Contract of Insurance has only a semblance of a wager but it is really a contract of indemnity for the following reasons:—

- (i) It is only a person possessing insurable interest that is permitted to insure life or property, and not any person as in the case of a wager :
- (ii) In the case of fire and marine insurance only the actual loss that is suffered by the party is borne by the insurance company, and not the full amount for which the property is insured ;

- (iii) Even in the case of life insurance the policy amount payable in the event of the assured's death is fixed because of the difficulty in estimating the loss caused by the death of an individual in terms of money, but the underlying idea is indemnification.

In a contract of wager no such restrictions exist. Therefore it is not correct to say that a contract of insurance is a contract of wager.

*Commercial wagers* :—These are contracts made on the stock exchange and other commercial exchanges for the sale and purchase of stocks and shares, or for the sale and delivery of goods, both the parties not intending that there should be any delivery of those shares or goods, but intending that only differences in the prices should be accounted for ; such contracts are void. The circumstance that either of the parties may require the performance under the contract does not prevent it from being a wager. *Universal Stock Exchange v. Strachan*, (1896) A. C. 166.

But where the parties do not intend while entering into the contract that only differences in price should be paid, the transaction, even though speculative, is valid but not void, for there is 'no law against speculation as there is against gambling'. *J. H. Todd v. Lakshmidas* (1892) 16 Bom. 441, 445. Thus speculative transactions must be distinguished from agreements by way of wager, though the distinction is by no means quite simple or clear. In each case it is a question of intention of the parties to be deduced by the Court having regard to the facts of the case, and course of dealing between the parties.

The Privy Council in *Sukhdevdoss Ramprasad v. Govindoss Chaturbhujdoss*, 51 Mad. 96 P.C., held :

"The mere fact that a contract for sale and purchase of goods is of a highly speculative character, cannot alone vitiate the transaction as a wagering contract. There must be proof that the contract was entered into upon terms that the performance of the contract should not be demanded but that differences only should be paid."

"*Tej*" *Mandi Transactions*.—In this transaction known as *Teji*, the buyer of the *Teji* pays the seller a premium also called *teji* in excess of the contract price of the goods. In consideration of that payment the buyer has, in the event of the market rising,



the option of asking the seller to deliver the goods or their value on the settling day. If the market falls the buyer simply loses his premium. The transactions known as "Vaida" transactions are on the same footing as the "Teji" transactions and unless it is affirmatively proved that the parties intended neither to ask for nor give delivery of the goods, they are not wagering contracts. *Narandos S. Rath v. Ghansyamdass A. I. R. 1933 Bom. 348* and *Sobhagmal Giammal v. Mukundchand Balia* 51 Bom. 1 (P.C.)

*Agreement between 'Pucca Adatia' and his constituents.*—Contracts between *Pucca Adatia* and his constituent called *Pucca Adit* are familiar in the Bombay market. These are contracts whereby an agent (*Pucca Adatia*) undertakes or guarantees that delivery should on the due date be given or taken at the price at which the order was accepted or differences paid. *Bhagwandas v. Kanji* 30 Bom. 205. A *Pucca Adatia* is a principal and not a disinterested middle man bringing two principals together. He undertakes to find goods for cash or cash for goods or to pay the differences. Whether this kind of transaction is a wager or not depends upon the intention of the parties, and the existence of *pakki adat* relationship does not itself negative the possibility of its being a wagering contract. *Burjorji v. Bhagwandas* 38 Bom. 204 (Though the decision of the High Court was reversed on appeal by the Privy Council, this principle was approved in *Bhagwandas v. Burjorji* 42 Bom. 373 (P. C.))

The *Pucca Adatia* transactions have to be contrasted with the '*Katcha Adatia*' transactions. In these cases, the '*Katcha Adat*' guarantees performance of the contract to the *Shroff* a third party in Bombay but does not guarantee its performance to his own principal, *viz.*, the up-country constituent. Since the *Katcha Adat* only acts as an agent, these transactions are not wagering contracts.

## 2. Immoral Agreements

1. *Agreements for illicit cohabitation.*—An agreement which has as its consideration illicit cohabitation is immoral, and it is therefore illegal, and not simply void.

In *Pears v. Brooke*, (1866) 1 Ex. 213 a prostitute hired a brougham for the purpose of display in her immoral trade, and the purpose for which it was taken was known to the coach-builder. In a suit by the coach-builder, for recovery of the hire it was held that the purpose being immoral even the collateral transaction was affected and that he could not succeed. Indian Law is the same.

*Past cohabitation.*—If a promise to pay money, by way of maintenance or otherwise is made in consideration of past illicit cohabitation the English Courts hold that they are not enforceable, not on the ground of immorality, but on the ground that past consideration is no consideration according to English Law. In the recent case of *Namberumal v. Veeraperumal*, 59 M. L. J. 596 the Madras High Court held that past consideration according to Sec. 2 (d) is valuable consideration, and that a promise made on account of past cohabitation is valid and enforceable. Where the cohabitation is of an adulterous kind, though it is past, the promise cannot be enforced, as adultery is an offence under the Penal Code.

*Agreements for separation.*—Both according to Indian Law as well as English Law, separation between husband and wife is considered as not conducive to good morals. Hence an agreement for future separation in both the countries is immoral, and hence illegal. But agreements for immediate separation are always enforceable.

### 3. Agreements contrary to Public Policy

Certain agreements which are not illegal or immoral, are declared by law to be void on the ground that they are opposed to public policy. Public policy is that principle of law which lays down that no one can be permitted to do that, which is likely to affect the interests of the public at large. Public Policy has been humorously described as an 'unruly horse' which is 'dangerous and difficult to ride' and judges have held that the principle ought not to be lightly extended. In the recent case of *Fender v. St. John Mildmay*, 53 T. L. R. 885, the House of Lords held that Courts have to be very careful in declaring a contract as being opposed to public policy, and that there was nothing opposed to public policy in a person whose marriage was dissolved by a decree nisi (*i.e.*, subject to confirmation) promising to marry another before such final dissolution. Public policy is undoubtedly a very vague term because it is not defined with precision anywhere. But with lapse of time certain agreements have been admittedly declared to be void on the ground that they are opposed to public policy, *viz.* :

1. *Agreements for the sale of public offices and titles.*—*Parkinson v. College of Ambulance Ltd.* (1925) 2 K.B. 1,

2. *Agreements tending to the abuse of legal process*.—An agreement to stifle prosecution is void. The defendant who raises this plea should establish a contract, whereby the proposed or actual prosecutor agreed as a part of the consideration received, or to be received by him, either not to bring or to discontinue criminal proceedings for some alleged offence. *Bhawanipur Banking Corporation v. Durgesh Nandini Dassi* I. L. R. 1942 (1) Cal. 1 (P.C.)

*Maintenance and Champerty*.—In England agreements of 'maintenance' and 'champerty' are considered to be void on the ground of their being opposed to public policy. Maintenance has been defined as the promotion of litigation in which a person has no interest of his own; in other words encouraging speculative litigation. Champerty has been defined as a bargain whereby one party is to assist another in recovering property and is to share in the proceeds of the action. Thus while the object of maintenance is to foment litigation, the object of champerty is to share the proceeds of the litigation. English Law holds both kinds of agreements as illegal and unenforceable. Indian Law is different, perhaps due to the fact that the average person in our country is not yet in position to safeguard his interests and successfully pilot his cause, however righteous it may be, through the trammels and technicalities of legal procedure.

In *Raja Venkata Subhadrayamma Garu v. Sree Pusapati Venkatapathi Raju*, 48 Mad. 230 (P.C.), the Privy Council held that champerty and maintenance are not illegal in India, and that Courts will refuse to enforce such agreements only when they are found to be extortionate and unconscionable, and not made with the *bona fide* object of assisting the claims of the person unable to carry on the litigation himself. In other words only those agreements which appear to be made for purposes of gambling in litigation and for injuring or oppressing others, by encouraging unholy litigation, that will not be enforced, and not all agreements of champerty or maintenance.

In *Lala Ram Sarup v. Court of Wards* I.L.R. 1940 Lahore 1 (P.C.) it was held that, though it is not conclusive, the proposition to be retained by the claimant is an important matter to be considered in judging the fairness of a bargain at the time when the result of the litigation was problematical, and that the financier may well be allowed some chance of exceptional advantage.

3. *Agreements in restraint of parental rights*.—In England as well as in India Courts have been zealous in safeguarding the rights of parents over their children, in regard to their custody

and their educational and religious training etc., and all agreements which contemplate an absolute transfer of such power from the parents or other lawful guardians to strangers, have been declared to be void as being opposed to public policy. *Giddu Narayanayya v. Mrs. Annie Besant*, 38 Mad. 807 (P.C.). In *Raja of Vizianagaram v. Secretary of State*, 71 M. L. J. 873 the Madras High Court refused to grant permission for removing the minor children of the Raja of Vizianagaram from India, and educating them in England against the wishes of the Raja, even though the education and maintenance of the minors were undertaken by the Court of Wards, in exercise of their powers of superintendence over the person and property of the Raja.

4. *Agreements in Restraint of Marriage*.—The law is always anxious that both men and women should live in lawful wedlock, and that they should be guided in the selection of their partners in life only by considerations of love, affection and their future welfare, and not by pecuniary considerations. In *Lowe v. Peers*, (1768) 98 E.R. 160, A promised to marry none else excepting Miss B, and if he did so to pay her a sum of £1,000; and when Miss B sued A for the recovery of that sum on the ground that A married somebody else, it was held that the contract was in restraint of marriage and as such void.

On the same principle Courts have held that marriage brocade contracts are void. A marriage brocade contract is one in which in consideration of marriage, one or other of the parties to it, or their parents, or third parties, receive a certain sum of money. Dowry system which is so familiar to us is according to strict law opposed to public policy. In *Venkatakrishna v. Venkatachalam*, 32 Madras 185, a sum of money was agreed to be paid to the father in consideration of his giving his daughter in marriage, and the Court held that such a promise amounted to a marriage brocade contract and was void. So in these cases if the marriage had already been performed, and the money has not been paid in pursuance of the agreement, it cannot be recovered in a Court of Law. If the money had been paid and the marriage also performed, the money cannot be got back.

The Indian Law is contained in §. 26, Contract Act, which lays down that "Every agreement in restraint of the marriage of any person, other than a minor, is void."

7. *Agreements in restraint of Trade.*—There are certain agreements which are not enforced by Courts of Law on the ground that they are in restraint of the right to carry on trade. Courts dislike any tendency to impose restrictions upon the liberty of an individual to carry on any calling, or profession, or trade, because such restraint not only diminishes the means of livelihood of the individual concerned but it also deprives the public of the skill and services of really capable persons, discourage industry and enterprise, and encourage enhancement of prices and monopoly of trade.

In England the rule originally was that all agreements in restraint of trade were void. To this rule an exception was engrafted in course of time, namely that partial restraint, or restraint confined to a limited time and space is valid, and enforceable. But later on this test for determining the validity or otherwise of an agreement in restraint of the trade was given the go-by, and the test of reasonableness was substituted.

*Nordenfelt v. Maxim Nordenfelt etc. Co.*, (1894) A. C. 535. In that case a Swedish gentleman sold the business of manufacturing guns and ammunition to Maxim Nordenfelt Co., for a particular sum, and agreed that for 55 years (i) he would not carry on similar business excepting on behalf of the company; and (ii) that he would not carry on any business which is likely to compete with the business of that company. The second covenant was admitted even by the company to be unenforceable, and an injunction was asked for preventing him (Swedish gentleman) from violating the first covenant. It was argued on his behalf that inasmuch as the first covenant contained only a partial covenant as to time and no partial covenant as to space, the agreement should not be enforced. The House of Lords, negating that contention, held that the real test for determining the validity of agreements in restraint of trade is, whether the restraint imposed is reasonable, for good consideration, not prejudicial to the interests of the public, and not more onerous than necessary for the protection of the party imposing the restraint. Applying this test it was held that the restraint was reasonable, and ought to be enforced.

In *Connors Bros. Ltd. v. Bernard Connors* A.I.R. (1941) P.C. 75 it was held that the extension of modern commerce and means of communication have displaced the old doctrine that an agreement of this kind must be confined within a definite neighbourhood.

In *Vancouver Malt and Sake Brewing Coy., Ltd. v. Vancouver Breweries Ltd.*, 66 M. L. J. 504, (an appeal from Columbia) it was held that a contract in restraint of trade could not be enforced unless (a) it was reasonable as between the parties and (b) it was

consistent with the interest of the public. In that case an agreement for sale of goodwill of the business of brewing beer by a company, which had license to manufacture beer but never carried on the said business, in favour of a company, which manufactured only beer, amounted to a restrictive covenant, for protection against mere competition, and that the covenant not being confined to any particular place but being very wide it could not pass the test of reasonableness as between the parties, and that it was therefore invalid and unenforceable.

An agreement not to sell goods below the manufacturers list of prices is not void as being in restraint of trade. *Palmolive Co. v. Freedman* (1928) 1 Ch. 264. Such a contract which is reasonable between the parties, will not be discharged on the ground of being unreasonable in public interests, unless the contract creates a monopoly calculated to enhance prices to an unreasonable extent. *Att-Gen of Australia v. Adelaide SS. Coy.* 1913 A. C. 781.

#### *Indian Law*

The Indian Law is contained in Sec. 27 of the Contract Act which reads as follows :—

“ Every agreement by which any one is restrained from exercising a lawful profession, trade, or business of any kind, is to that extent void.”

To this rule there are some exceptions, one of which is to be found in the Contract Act while the rest are dealt with in Sec. 11 (2), Sec. 36 (2) and Sec. 54 of the Partnership Act.

I. According to the first exception, though an agreement is in restraint of trade it will be enforced :

- (i) if the agreement relates to the sale of goodwill of a business, and
- (ii) the buyer agrees to refrain from carrying on similar business,
- (iii) within specified local limits,
- (iv) so long as the buyer or his representative carries on the business purchased by him ; and
- (v) provided the limits as to space appear to the Court to be reasonable under the circumstances. (Sec. 27) (Sec. 55 (3) of the Partnership Act lays down a similar rule).

Exceptions contained in the Partnership Act are for the sake of convenience mentioned here, and according to them an agreement in restraint of trade will be enforced, if it satisfies the following conditions.

- II. (i) If the agreement is between partners upon or in anticipation of the dissolution of the firm ; and
  - (ii) some or all of them agree not to carry on similar business within certain local limits ; and
  - (iii) such local limits appear to be reasonable (Sec. 54, Indian partnership Act.)
- III. (i) If the agreement is between the partners ; and
  - (ii) some or all of them agree that they will not carry on any business other than that of the firm, while they continue to be partners (Sec. 11 (2), Indian Partnership Act.)

IV. An agreement similar to the one are in Sec. 11 (2) between a retiring partner and the continuing partners or partner, not to carry on any business similar to that of the firm within a specified period or within specified local limits. (Sec. 36 (2), Indian Partnership Act.)

It may be observed that the Indian Law even to-day is in the position of the English Law prior to the decision in *Nordenfelts case*, and reasonableness of restraint is yet not the test for determining the validity of an agreement in restraint of trade, but the test is whether such an agreement falls within the four corners of one or the other of the exceptions.

*Trade Unions and contracts.*—Sec. 19 of the Trade Unions' Act lays down that, notwithstanding anything contained in any law for the time being in force, an agreement between the members of a registered trade union shall not be void or voidable merely by reason of the fact that any of the objects of the agreement are in restraint of trade. Therefore these agreements between members of a trade union are also an exception to Sec. 27 of the Contract Act.

*Trade combinations.*—In *Fraser & Co. v. Bombay Ice Manufacturing Co.*, 29 Bom. 107, it was held that a combination between traders for the purpose of keeping up the price of ice, and restraining every one from lowering the rate, is not void within the meaning of Sec. 27 of the Contract Act.

8. *Agreements in Restraint of Personal freedom.*—Public policy insists upon every man having unfettered personal freedom, and any agreement which tends to unduly restrict the personal freedom of an individual is therefore void both according to English and Indian Law. In one case it was held by the Madras High Court that an agreement whereby a borrower and his wife had to render service valued at a rate which would not even permit the interest to be discharged, was void as it amounted to virtual slavery.

*Effect of illegality.*—As has been already stated, the object of law in declaring illegal or unlawful agreements as void is to put down all base conduct on the part of men, and is expressed by the Latin maxim "*Ex turpi causa non oritur actio*," i.e., out of a turpitude no cause of action arises. The law renders no assistance to the guilty party in such a case, and consequently any money paid, or goods supplied under such a contract cannot be recovered. It is true that the defendant in such a case, who is equally guilty, would stand to gain, but the law allows him to have that advantage not because it approves of his conduct, but because it is not prepared to enforce or grant any relief on the basis of the illegal agreement. The rule that the condition of the defendant in such cases is better is expressed by the maxim '*in pari delicto potior est conditio defendantis*' i.e., in cases of equal guilt the condition of the defendant is better. So if A promises to pay B Rs. 100 for murdering C, B cannot recover the money in a Court of Law by proving that he committed the murder as promised, because murder is the most heinous crime and cannot be recognised as the consideration for any agreement. If the murder had been committed and the money was paid by A to B, even prior to its commission, A cannot get back the money from B by disclosing the heinous conduct of B, because A did not come to the Court till the illegal purpose had been carried out, and as such he is equally to blame, and does not deserve any help of the Court.

The following are exceptions to this rule :

(1) Where the plaintiff need not, plead nor rely upon the illegal transaction, for obtaining the relief claimed by him.

(2) Where the illegal transaction has not been carried out either in whole or in part. Thus in the above illustration if A



had paid the money to B, but before the murder is committed, A comes to Court for recovering the same, on the ground that he has abandoned the evil project, the Court will certainly help him, because it is the object of law to encourage repentance even in bad men, before it is too late. To this an exception has been made in the case of marriage brokerage contracts. *Hermann v. Charlesworth*, (1905) 2 K.B. 123.

(3) Where the parties are not *pari delicto* (equally guilty) *e.g.*, where the plaintiff (debtor) was induced to enter into the contract by fraud or strong pressure of the defendant, (creditor), the plaintiff can recover the money paid by him, *Atkinson v. Denby* (1802) 7 H & N. 934.

*Latent and Supervening illegality :*

Having seen that an illegal agreement is void, it is necessary to remember that the illegality may not always appear on the face of it. In such cases evidence may be permitted to prove the illegality. Such illegalities are called *latent illegalities*.

Further an agreement may not be illegal at the time of its formation, but may become illegal subsequently. For instance, an agreement between two merchants entered into in 1936 for importing intoxicating drinks into the district of Salem might have been perfectly valid, but if it is sought to be enforced in a Court of Law in 1938, it should be declared void, because there is a subsequent or supervening illegality, (as distinguished from initial illegality) on account of the passing of the Prohibition Act of 1937.

*Whether illegality is severable.*—Where a contract consists of certain terms which are legal, and some others which are illegal, and they are severable from each other the Court will not refuse to enforce the entire contract, but will enforce the legal part and reject that which is illegal. Where the illegal part cannot be separated from the legal, the entire contract will be declared illegal. The same rule applies where part of the consideration is illegal and part of it is legal. The law in India is laid down as follows :

*Agreements void, if consideration and objects unlawful in part :* If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object is unlawful, the agreement is void (S. 24),

*Reciprocal promise to do things legal, and also other things illegal :* " Where persons reciprocally promise firstly to do certain things which are legal, and secondly under specified circumstances, to do certain other things which are illegal, the first set of promises is a contract, but the second is a void agreement (S. 57).

*Alternative promises, one branch being illegal :* In the case of an alternative promise one branch of which is legal and the other illegal, the legal branch alone can be enforced (S. 58).

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## CHAPTER XI

### PERFORMANCE OF CONTRACT

*Contingent Contracts.*—A *contingent contract* is also called a *conditional contract* and it has to be distinguished from an *absolute contract*. In the case of a contingent contract, the performance is made to depend upon the happening of some event, certain or uncertain ; in other words the performance of such a contract is made to depend on an event which is future as well as contingent. S. 31, enacts : “ A contingent contract is a contract to do or not to do something, if some event *collateral to such contract*, does or does not happen”. A promises to pay B Rs. 500, if B's car is destroyed by fire. It is a contingent contract. The important point to be noted is that the condition on which the performance is made to depend, is an event collateral to the contract, and does not form part of the reciprocal promises which constitute the contract. A contingent contract has therefore to be distinguished from a contract in which the performance by one party is conditional upon the performance, or readiness and willingness to perform, by the other. For instance if A agrees to deliver 100 bags of rice and B agrees to pay the price only afterwards, the obligation of B to perform his promise is conditional upon A's performance first, but this is not a contingent contract, because the event on which B's liability is made to depend is a part of the promise itself, and not a collateral event. Another point to be noted is that the contingent event may be an *act* entirely within the will of the promisor, but it should not be the mere *will* of the promisor. For instance if A promises to pay B Rs. 500 *if he so chose*, it is not a contingent contract because the payment is to depend on his will, but on the other hand if A says that he will pay B Rs. 500, if A left Madras for Calcutta, that is a contingent contract, because going to Calcutta is an event no doubt within A's will, but is not simply his will.

The law relating to contingent contracts is laid down in Secs. 32 to 36 of the Contract Act, and the following principles can be gathered therefrom.

I. "Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. If the event becomes impossible such contracts become void." (Section 32).

II. "Contingent contracts to do or not to do anything if an uncertain future event does not happen can be enforced when the happening of that event becomes impossible, and not before." (Section 33).

III. "If the future event on which a contract is contingent is the way in which a person would act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time, or otherwise than under further contingencies." (Sec. 34).

IV. "Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time become void if, at the expiration of the time fixed, such event has not happened, or if before the time fixed such event becomes impossible." (Sec. 35).

*Illustration.*—A promises to pay B if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.

V. "Contingent contracts to do or not to do anything if a specified uncertain event does not happen within a fixed time may be enforced by law when the time fixed has expired, and such event has not happened, or before the time fixed has expired, if it becomes certain that such event will not happen." (Sec. 35).

*Illustration.*—A promises to pay B a sum of money if a certain ship does not return within a year. The contract may be enforced if the ship does not return within the year, or is burnt within the year.

VI. "Contingent agreements to do or not to do anything, if an impossible event happens, are void, whether the impossibility is known or not to the parties to the agreement at the time when it is made." (Sec. 36).

*Illustration.*—A agrees to pay B Rs. 1,000 if two straight lines should enclose a space. The agreement is void.

*Order of performance of reciprocal promises* :—The question when a party should perform his part of the contract arises in the case of bilateral contracts, where promises of both the parties are outstanding. From this standpoint mutual or reciprocal promises can be divided into 3 headings :—

- (1) Mutual and dependent,
- (2) Mutual and independent,
- (3) Mutual and concurrent.

The Indian Law is contained in Secs. 51, 52 and 54, Contract Act.

(1) Section 52 reads as follows :—

“ Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order ; and, where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires.”

This Section deals with *mutual and independent promises*. Thus if A promises to deliver his horse to B on 1st January, and B promises to pay the price on 1st February, they are two mutual and independent promises, and A can claim payment of money from B, notwithstanding his not delivering the horse on 1st January ; but of course, B will have his own remedy by way of damages against A for not performing his part of the contract.

(2) Sec. 54, reads thus :

“ Where a contract consists of reciprocal promises such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed and the promisor of the promise last mentioned fails to perform it, such promisor can claim the performance of the reciprocal promise, and must make compensation to the other party for any loss which such other party may sustain by non-performance of the contract.”

This Section deals with *mutual and dependent promises e.g.*, A contracts with B to construct a building for a fixed price, B supplying the necessary timber. B fails to furnish the timber and the work cannot be executed. A need not execute the work and B is bound to compensate A for the loss caused to B, as A's promise to perform is dependent upon B's performance.

## (3) Sec. 51 enacts :—

“ When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.”

This Section deals with *mutual and concurrent promises*. A and B contract that A shall deliver goods to B, to be paid for by B on delivery. Here the promise of each should be performed simultaneously, and so A need not deliver the goods unless B is ready and willing to pay for the goods on delivery ; and B need not pay for the goods unless A is ready and willing to deliver them on payment.

## Manner of Performance

(a) *Demand for Performance*.—The question naturally arises whether in a case where the time of performance is not specifically mentioned, the promisor should wait till the promisee calls for the performance, or is bound to perform even without such request. According to English Law no request or demand for performance is necessary, but under Sec. 35 of the Sale of Goods Act, as well as Sec. 48 of the Contract Act a demand for performance seems to be necessary. Section 48 reads thus :—

“ When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at a proper place and within the usual hours of business.

*Explanation*.—The question “what is a proper time and place” is in each particular case a question of fact.”

(b) *Time of performance*.—Where the time for performance has been specified, the promisor is bound to perform on the day fixed during the usual business hours, and at the *place* at which the promise ought to be performed. But where the time is not specified in the contract, and the promisor is to perform his part without application by the promisee, the performance must be made within a reasonable time. What is reasonable time is a question of fact.

The Indian Law is the same and is contained in Secs. 46, 47 and 50 of the Contract Act.

(c) *Place of Performance*.—If a place for performance is fixed by the contract, the promisor is bound to perform at that place, and if no place is mentioned, it depends on the intention of the parties, as can be gathered from the circumstances of the case. But according to Sec. 49 when the promisor has to perform without application by the promisee, and no place for performance is specified, it is the duty of the promisor to get a place for the performance appointed, and perform it at that place.

*Appropriation of Payments*.—Closely connected with the subject of the place and time of performance, is that dealing with the rights of parties to appropriate payments made, in case where there are several debts owing by one party to the other. Where at the time of payment definite instructions are given by the debtor, there is no difficulty, because the creditor is bound by them. But the trouble arises only when no such instructions are given by the debtor, and even the creditor does not appropriate the payment towards a particular debt. The English Law on the subject is laid down in *Clayton's case* (1816) 1 Mer. 572 and the principles laid down in that case are embodied in Secs. 59 to 61 of the Contract Act as follows :

If a debtor owes more than one debt to his creditor, and pays him a sum of money which is insufficient to liquidate the entire debt :—

- (1) The debtor has the right to appropriate it either expressly or by implication, towards any debt due to his creditor ;
- (2) If at the time of paying the money the debtor gives no express or implied direction regarding appropriation, the creditor has the right up to the last moment to appropriate the same towards any of the debts due—even the time-barred ones, or those unenforceable for want of proof, but not to one which is illegal ;
- (3) In the absence of appropriation by the debtor or the creditor, the Court will appropriate the sum towards one debt after another in the order of time, notwithstanding that some of them are barred by limitation. Where all the debts are of equal standing the amount will be distributed between all the debts proportionately.

**Note :**

In the case of a current account the presumption is that the sum first paid was first drawn out, and the first item on the debit item is reduced by the first item on the credit side, *Deeley v. Lloyds Bank Ltd.*, (1912) A.C. 756.

**Performance of Obligations**

It is clear that a person who has undertaken to perform a certain act is bound to do it, but what happens if he dies leaving his legal representatives? The rule that a personal action dies with the person, '*actio personalis moritur cum persona*', has no application to suits based on contracts, and it applies only to torts. So in the case of contractual obligations, even though the promisor dies, his legal representative has to perform the promise, provided it is not one dependent upon personal qualifications. For instance, if A promises to deliver goods to B on a certain day on payment of Rs. 1,000, and A dies before the stipulated day, A's legal representatives must deliver the goods to B on payment of the price, or else will be liable to pay damages out of A's estate. One thing that must be remembered is that the legal representatives of A do not incur any personal obligation but are liable to perform A's promise or pay damages so far as A's estate permits. If on the other hand A promises to marry Miss B she can, in no event, seek to enforce that promise against A's representatives because a promise to marry is of a purely personal nature. The rule is expressed thus :

"The parties to a contract must either perform or offer to perform the respective promises, unless such performance is dispensed with or excused under the provisions of this Act or any other law. Promises bind the representatives of the promisors in case of the death of such promisors before performance unless a contrary intention appears from the contract." (Sec. 37.)

**Joint promisors and Joint promisees :** A promise made by two or more persons may be one of two kinds : (i) joint promise or (ii) joint and several promise. The difference between the two is of great practical importance in England because every joint promise is not a joint and several promise. In India the law is simple, because in the absence of contract to the contrary, all joint promises are joint and several promises,



The points of difference between the two types of promises may now be noted :

(i) If A, B and C borrow Rs. 3,000 from D under a single money bond it is called a joint liability, and D cannot recover from any one of them more than Rs. 1,000, though he might have obtained a decree against all of them for the entire amount. But if on the other hand A, B and C in addition to their joint promise, also agree that each of them shall be liable to pay the entire amount, the liability is called joint and several. In such a case D can, in the above illustration, recover the entire amount from any one or some of them. But it is open to that person or persons, who have paid more than their share, to obtain contribution from the others. (ii) A release of one of the joint promisors, without the consent of the other promisors, operates as a release of all of them. But in the case of a joint and several promise it does not (Sec. 44). (iii) In the case of death of one of the joint promisors, the liability devolves on the survivors, *i.e.*, in the above illustration, in the case of the joint promise, if A dies, his liability devolves upon B and C, and if B later on dies only upon C, and if C also dies, upon his representatives. But if the promise were joint and several, after A's death the liability would devolve upon A's representatives, and B and C, and they will all be jointly and severally liable. Similarly on B's death the legal representatives of A and B, and C will be jointly and severally liable. On the death of C the legal representatives of all the three persons will be jointly and severally liable (Sec. 42).

In India the law relating to devolution of liability in the case of joint promises, called joint liability, is contained in Sec. 43 of the Contract Act which runs thus :—

“When two or more persons make a joint promise, the promisee may, in absence of express agreement to the contrary, compel any one or more of such joint promisors to perform the whole of the promise.

Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise, unless a contrary intention appears from the contract.

If any one of two or more joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares"

Thus according to Indian Law, unless a contrary intention is made to appear in express terms, every joint promise is a joint and several promise, and the right of contribution amongst joint promisors is also expressly provided for.

*Assignments of contracts.*—We have already seen that a contractual right is called a chose-in-action. An assignment of such a right is also called an assignment of a chose-in action.

Originally Common Law did not recognise the assignment of even contractual rights, and the assignee in such cases could not enforce the promise against the promisor. But Equity permitted assignment of contractual rights. Since the passing of the Judicature Act of 1873 and the Law of Property Act 1925, it is now possible according to English Law to make an assignment of contractual rights subject to the following conditions :—

- (1) The assignment must be in writing signed by the assignor.
- (2) It must be absolute and not by way of charge, and it should be of the whole debt.
- (3) The assignee must give notice in writing of the fact of assignment to the promisor.

Even to this rule it should be remembered that there is one limitation, *viz.*, that promises made in consideration of personal qualifications like skill, intelligence, appearance, wealth, etc., cannot be transferred to another. For instance, a promise made to A to appoint him as an Engineer on a monthly salary of Rs. 500 cannot be assigned by him in favour of his friend B even assuming that B is an Engineer.

If an assignment satisfies the above conditions it is valid at law and is called a *legal assignment*. Even if all the above conditions are not satisfied, but the intention to assign is clear it is valid in Equity, and is called an *Equitable assignment*.

The Indian Law is the same, and a chose-in-action can be assigned under Sec. 130 of the Transfer of Property Act.

As regards the contractual liability, the general rule in India as well as in England, is that it cannot be transferred without the consent of the promisee. For instance, if A owes Rs. 100

to B, A cannot depute C by means of an agreement with him to discharge the debt of B, and thus prevent B from suing A.

The leading case on this point is *Robson and Sharpe v. Drummond*, (1831) 109 E. R. 1156. D agreed to take from S, a coach-builder, a carriage on hire for a period of 5 years, S being bound to look to the excellent condition of the carriage. After three years S assigned his business to one R, and D refused to be bound by the contract. The Court held that since D was induced to enter into the contract by reason of the personal confidence in S, S could not get the work done by R, against the wishes of D so as to bind him.

But to this rule there are the following exceptions :—

I. *Novation, i.e.*, where a new contract is substituted in the place of the old one, by means of an agreement between the same parties, or between them and a stranger. Thus if A is bound to pay Rs. 100 to B, and in its stead A executes a mortgage in favour of B for the like amount, the original contract gets replaced by or merged in the new contract contained in the mortgage, and the former need not be performed.

In the same illustration, if A enters into an agreement with B and also C, whereby C who has to pay Rs. 100 to A agrees to pay that amount to B in discharge of A's liability to B, and B agrees to that course, then there is a tripartite agreement between the three persons A, B & C, and the original promise of A to B is substituted by the promise of C to A, and the original promise need not then be performed. Both the above cases are examples of novation. The Indian Law is expressed thus : "If the parties to a contract agree to substitute a new contract for it or to rescind or alter it, the original contract need not be performed." (Sec. 62).

II. The second exception is expressed in Sec. 40 thus:— "If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it should be performed by the promisor himself, such promise must be performed by the promisor. In other cases the promisor or his representatives may employ a competent person to perform it." This is only a seeming exception, because it only gives a right to get certain promises not involving personal qualifications to be done by others. But even in such a case it does not absolve the liability of the promisor for the due performance of the promise. But if performance from the third party is accepted, the original promise cannot be enforced. Sec. 41 enacts thus:— "Where a promisee accepts performance of the promise

from a third person, he cannot afterwards enforce it against the promisor."

*Persons entitled to claim performance.*—If the promise is in favour of only one individual, the performance can be claimed by himself or by his legal representatives or by his assignees. But in the case of joint promisees, all of them together, or in case one of them dies, the survivors, can claim the performance, and upon the death of the last survivor the right to claim performance vests in his legal representatives.

But the rule in India is different and is contained in Sec. 45 of the Contract Act which reads as follows:—

"When a person has made a promise to two or more persons jointly, then unless a contrary intention appears from the contract, the right to claim performance rests as between him and them, with them during their joint lives, and after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and after the death of the last survivor, with the representatives of all jointly."

But it should be noted that in India as well as in England, one of the joint promisees cannot file a suit in respect of the entire promise nor even to the extent of his share. All the joint promisees should sue together and if any of them do not join they should be added as defendants.

*Tender of Performance.*—The best way in which a contractual obligation can be discharged is by performing it, and we have seen already the various rules governing performance. But tender of performance is treated as performance itself, because the person tendering has done what all he has to do under law. In order that a tender should operate as performance, it must have been made strictly in accordance with the terms of the contract and yet refused by the promisee. Thus if A is bound to deliver 10 bales of cotton on a particular day to B, and he has to pay A Rs. 1000, if A on the appointed day and at the appointed place delivers the identical quality of cotton in ten bales, he is said to make a tender of performance, and if such performance is not accepted, B will be liable to pay damages, as if A has performed his part. Tender is also called *attempted performance*.

The law in India is the same, and is contained in Sec. 38 of the Contract Act and the *essentials of valid tender* are as follows :

1. It must be unconditional.
2. It must be made at the proper time and proper place.
3. It must be made under circumstances enabling the other party to ascertain that the person by whom it is made is able and willing then and there to do the whole of what he is bound by his promise to do.
4. If the tender relates to the delivery of goods the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver.
5. Tender made to one of several promisees has the same effect as a tender to all of them.

*Release or Waiver:*—At any time before the performance of a bilateral contract is due, either party may release his respective rights under the contract, when the contract need not be performed. According to English law, on account of the doctrine of consideration, a release by the promisee of his rights under a unilateral contract should, in order to be effectual and binding, be made under seal. The rule is the same even where the release is sought to be made, after the breach of the contract. In India there need not be any consideration for release of contractual rights, as the technical rules of accord and satisfaction do not exist in our country (*supra*). Therefore a release of the rights, howsoever made, will be binding on the party releasing them. Sec. 63 enacts "Every promisee may dispense with or remit, wholly or in part, the performance of the promise made to him, or may extend the time for such performance, or may accept instead of it any satisfaction which he thinks fit."



## CHAPTER XII

### DISCHARGE OF CONTRACT

We have already seen that the parties to a contract must either perform or offer to perform the contract, unless its performance is excused under law. When a contract is performed or a valid tender is made, it becomes discharged. Even if there is no performance of the contract, it is discharged, though on account of the breach of contract, the aggrieved party may claim the remedy of damages, or specific performance as the case may be. In some other cases also a contract is discharged *e.g.*, by the happening of certain events over which parties have absolutely no control. The cases in which a contract is discharged can be classified as follows :—1. Performance or tender (Secs. 37 & 38), 2. Novation (Sec. 62), 3. Release or waiver (Sec. 63), 4. Breach (Secs. 39 and 55), 5. Impossibility of performance (Sec. 56).

We have already considered in the previous chapter the law relating to discharge of contracts, falling under the headings 1 to 3. We shall now consider the discharge of contract by breach, and impossibility of performance.

**Discharge of contract by breach.**—Breach of contract may take place in the following ways :

1. When performance is actually due; or 2. While performing the contract, or 3. Prior to the date of performance, called anticipatory breach.

(1) *Breach of contract when performance is actually due.*—If a person does not perform his part of the contract at the stipulated time, he will be liable for its breach. But if the promisor offers to perform his promise subsequently, the question arises whether it should be accepted, or whether the promisee can refuse such acceptance and hold the promisor liable for the breach. The answer to this question depends upon whether time was considered by the parties to be the essence of the contract or not.

In England the rule is, that unless specifically stipulated, time is not the essence of the contract, and specific performance would

be decreed even though the plaintiff failed to perform his part of the contract within the stipulated time. To this rule there is one exception, namely stipulations relating to time for the delivery of goods in commercial contracts. In those cases time is presumed to be of the essence of the contract, because the constant fluctuations in prices make non-performance at the proper time entail very serious and irreparable loss. But even in commercial transactions, stipulations relating to payment of price are not deemed to be of the essence of the contract.

The Indian Law is almost the same, and is contained in Sec. 55 of the Contract Act which reads as follows :—

“When a party to a contract promises to do a certain thing at or before a specified time, or certain things, at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it, as has not been performed becomes voidable at the option of the promisee, if the intention of the parties was, that time should be the essence of the contract. If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such things at or before the specified time; but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure. If in case of a contract, voidable on account of the promisor's failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless at the time of such acceptance, he gives notice to the promisor of his intention to do so.”

One point of difference between the English and the Indian Law has to be noted. According to the section, if performance beyond the stipulated time is accepted, and the promisee does not give notice, while accepting it, that he intends to claim compensation, he will be deemed to have waived that right. But in England no such notice is necessary, and the promisee can, even after accepting the belated performance, claim compensation.

(2) *Breach in the course of performance of the contract.*—We have already seen that the terms in a contract may be either

conditions or warranties, and the difference between the two has been noted. Condition being an essential term of the contract, if the party liable to perform the condition fails to do so, the other party need not perform his part, but can repudiate his obligations under the contract. *Behn v. Burness*, (1863) 122 E.R. 281. But in the case of a warranty, its non-fulfilment does not enable the other party to repudiate the contract altogether, but only gives him a right to claim damages from the party liable for its breach. *Bettini v. Gye*, (1876) 1 Q.B.D. 183. In cases where performance consists of delivery of goods in instalments, the rule is that if the failure of the party to deliver one instalment is such, that it goes to the root of the contract, and also indicates an intention of that person not to perform it, then the other party is discharged from his obligation, and he can repudiate the contract. *Freeth v. Burr*, (1873) 9 C.P. 208, and *Mersey Steel & Iron Co. v. Naylor*, (1884) 9 A.C. 434. If it does not go to the root of the contract, the other party can only obtain damages, but cannot repudiate the contract.

(3) *Anticipatory breach, or breach of contract before the date of performance.*—When a person makes a promise to another, not only should he perform it on its due date, but he should also keep the contract alive, as an effective and subsisting one till that date. Therefore if A, a party to a contract, repudiates it or renounces his obligations under it prior to the date of performance, the other party to the contract B is entitled to accept the same and terminate the contract. After having accepted such renunciation, B is freed from his obligation of getting ready for performing his part, and he can file a suit immediately, claiming prospective damages, without waiting till the date of performance. Further B should try to mitigate his damages, by getting the goods or services promised by A from some one else, and not aggravate the loss with a view to claim larger amount of damages. Even if B does not try to minimise damages, the Court will award only such damages subject to any circumstances which might operate in mitigation of damages. This is the rule relating to anticipatory breach of contract.

The leading case on this point is *Hochster v. De la Tour*, (1853) 118 E. R. 922, where A entered into a contract with B for B's services as a courier for three months on a foreign tour commencing from a particular date. Even before that date A wrote to B dispensing with his (B's) services. Held that B



need not make the necessary preparations for joining service and that he could file a suit immediately after the renunciation of the contract by A, without waiting till the date of performance.

In *Frost v. Knight*, (1872) 7 Ex. 111, it was held that the rule in the above case applied even in the case of contingent contracts.

But one important point which should be noted is, that if the other party does not accept the repudiation but keeps the contract alive, he keeps it open and operative for the benefit of himself as well as the person repudiating the contract, so that the latter can, notwithstanding his repudiation, take advantage of circumstances which would discharge him from liability at the time of performance.

This principle was laid down in *Avery v. Bowden*, (1856) 119 E. R. 1122. A agreed to load cargo at Odessa in B's vessels on a certain date. The vessel arrived a few days prior to that date, and the master of that vessel was informed by A that he would not supply the cargo. The master did not accept the repudiation but went on making demands for cargo till the last date, by which time war broke out. Held that as the repudiation by A was not accepted, the contract was kept alive, for the benefit of both the parties, and that A was entitled to take advantage of the discharge of the contract brought about by the declaration of war, and that A was not liable to pay any damages.

Another point which should be noted is, that after a repudiation of the contract is accepted by the other party, it is not open to the party repudiating, to contend that the party accepting it was not in a position to perform the contract, if the repudiation had not been made. This was laid down in *Braithwaite v. Foreign Hardwood Co.*, (1905) 2 K. B. 543.

The Indian Law is contained in Sec. 39 which reads as follows :—

“When a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance.”

And Sec. 75 enacts that “a person who rightly rescinds a contract is entitled to compensation for any damage which he has sustained through the nonfulfilment of the contract.”

*Impossibility of performance.*—When parties substitute one contract for another, we noticed that the original contract need not be performed. Similarly, if parties agree that on the happen-

ing of certain events which render the contract impossible of performance, the contract need not be performed, the happening of those events would absolve the parties from performance. Where the contract is so clearly worded, there is no difficulty. But much trouble arises where parties do not clearly express themselves, but yet proceed on an assumption, that if certain events happen, (which render performance of the contract inequitable, if not impossible) the contract need not be performed. In such cases also, the law declares the contracts void, on the ground of impossibility of performance, and the principle is justified on the ground of consent of the parties, which is implied under the circumstances.

The plea of impossibility of performance is recognised in the following cases ;—

1. Destruction of subject-matter of the contract.
2. Death or disablement of parties.
3. Contract becoming subsequently illegal.
4. Declaration of war.
5. Frustration.

(1) *Destruction of subject-matter of the contract.*—Where the subject-matter of a contract is destroyed, for no fault of the promisor, it is but just that he should be absolved from performing his promise because, such a term is implied in the contract.

The leading case on this point is *Taylor v. Caldwell*, (1863) 122 E. R. 309. In this case a music hall was agreed to be let out on certain dates but before those dates it was destroyed by fire. Held that the owner was absolved from liability to let the building as promised. It was observed in this case that “when entering into the contract, they must have contemplated such continuing existence of the building as foundation of what was to be done, then..... the contract is.....subject to an implied condition that the parties shall be excused in case, before such breach, performance becomes impossible from the perishing of the thing without default of the contractor.”

(2) *Death or disablement of parties.*—Where the promisor dies or is physically rendered unable to perform a contract, which should be performed by him personally, it is but just that he should be exonerated from performance, because his death or disablement is an Act of God or *Vis Major*, over which he has no control. But this is only an exception which came to be recognised in England subsequently for, the original rule at common law, known as the rule in *Paradine v. Jane*, (1647) 82 E.R. 897, was to the effect that a man must do or die, and no Court could excuse

performance. The leading case illustrating the exception to the rule in *Paradine's case* is *Robinson v. Davison*, (1871) 40 L. J. Ex. 172. In that case a pianist fell ill, and could not play at a concert as promised by him. Held that the pianist was not liable to pay damages, because the parties contemplated, or should be deemed to have contemplated, that he should perform it subject to the condition of sound health.

(3) *Subsequent illegality*.—Where by subsequent legislation the performance of a contract is forbidden by law, the parties are absolved from liability to perform it.

In *Baily v. De Crespigny*, (1869) 4 Q. B. 180 A, while purchasing a plot of land from B, agreed not to construct buildings on that site. Subsequently by an Act of Parliament the site was acquired by a railway company, and buildings were raised thereon. In a suit by B against A for breach of the agreement, held that A was discharged from liability, as the compliance with the agreement became impossible by subsequent legislation.

(4) *Declaration of War*.—As has been noticed *supra*, the moment a war is declared, the subjects of one country should not enter into contracts with the subjects of the enemy country. If the contract has been entered into prior to the declaration of war, its performance would be suspended during war, if it is for a short period, and if it is for a sufficiently long period the parties would be exonerated from performance, on the ground of its impossibility.

In *Metropolitan Water Board v. Dick Kerr & Co., Ltd.*, (1918) A. C. 119. a contract was entered in 1914 for the construction of a reservoir in six years. On account of the Great War, the work had to be suspended in 1916. In a suit for damages it was observed that on account of the suspension of performance for some years during the war, the contract must have been greatly altered, and to compel a party to perform it would be to compel performance of an altogether new contract. It was therefore held that the contract became impossible of performance and the defendant was not liable to pay damages.

(5) *Frustration*.—The word frustration is used with reference to contracts which have become impossible of performance, not because the performance is physically impossible, but because the performance on the stipulated date would be violating or frustrating the fundamental object of the contract. In these cases the law says that the contract need not be performed, on the principle that the parties have impliedly agreed that in case the contract at the time of performance would be different from the one con-

templated to be performed, it need not be performed. The leading case on this point is *Krell v. Henry*, (1903) 2 K. B. 740, one of a series known as coronation cases.

In *Krell v. Henry* the contract was to hire a flat for viewing the coronation procession of the King in 1902. The procession had to be abandoned on account of the King's illness, and a suit was filed for the recovery of the rent. It was held that though there was no term relating to the object with which the contract was made still, it should be deemed to be one for viewing the procession, and inasmuch as that object had been frustrated on account of the King's illness, the contract became impossible of performance, and that the hirer need not pay the rent.

In *Bell v. Lever Bros.*, (1932) A. C. 160, it was held that the doctrine of frustration was not a rule empowering Courts to excuse performance in certain cases, because no Court has got such a power; but it was observed that it was only a principle which lays down that a condition of the contract, though not expressed, if frustrated, would excuse parties from further performance. It therefore follows that in cases where the existence of such implied condition is negatived on account of other terms, or surrounding circumstances, the doctrine of frustration would not apply.

In *Twentsche Oversea Trading Co. Ltd., v. Uganda Sugar Factory Ltd.*, (1945) 1 M.L.J. 417 (P.C.), (from East Africa) it was held that where only one of the many possible ways of performing a contract had become illegal or impossible, and the shipment of goods from Germany (enemy country) was not made the basis or foundation of the contract, the doctrine of frustration could not be invoked, though in fact the party pleading frustration intended the shipment from Germany to be the source of his supply. It was also held that the doctrine of frustration applies to contracts in respect of unascertained goods, and that the doctrine is no doubt beneficial, but must be applied with circumspection.

In *Maritime National Fish Ltd. v. Ocean Trawlers Ltd.*, (1935) A.C. 524 (P.C.) an appeal from Canada, a charter party contract became impossible of performance in consequence of the owner of the ship not electing to obtain from the Government a license for the chartered ship, but obtaining the same for some other ship of his. Held that the party's default frustrated the adventure, and that he could not rely on his own default for excusing him from liability, on the ground of frustration.

As the effect of frustration is to discharge parties only from future performance, but not to render the contract void *ab initio* it was held that any payment actually accrued due prior to frustration could be recovered, and if already paid by the other party in accordance with the contract, it need not be refunded. This is known as the rule in *Chandler v. Webster* (1904) 1 K.B. 493.

In *Chandler v. Webster*, (1904) 1 K.B. 493, one of the coronation cases, the contract was to hire rooms for £140, the hirer being bound to pay the hire in advance. The hirer paid only £100 on account, and when the procession had to be abandoned on account of the King's illness, the hirer filed a suit for the refund of £100 paid by him, while the owner of the rooms made a counter claim for £40 the balance due to him. The Court held that the amount already paid need not be refunded, and that the balance of £40 which became due prior to the contract becoming frustrated, should be paid to the owner, on the ground that in case of breach by frustration it is only future obligations that are rendered void, but not those which became due prior to the date of frustration.

This rule which prevented recovery of the money paid, for which in fact no value had been received, was recognised to be harsh, and the Law Revision Committee of England recommended its abolition, and also made some other recommendations. The House of Lords had finally extinguished this rule in *Fibrosa Spolka Akcyjna v. Fairbairn, Lawson, Combe Barbour Ltd.*, (1943) A.C. 32.

A contracted to manufacture and deliver to B certain machinery, part of the price to be paid in advance. B accordingly paid £1,000. Performance of the contract by B became impossible, on account of declaration of war and the contract became frustrated. Held overruling *Chandler v. Webster* B was entitled to recover £1,000 on the basis of total failure of consideration, and that the foundation of B's right was quasi contract and not contract, as was wrongly supposed by Collins M.R. in *Chandler v. Webster*.

Lord Simon observed in *Fibrosa's case* that, though in the law relating to formation of contract, a promise to do a thing may be a consideration, in the law of failure of consideration and of quasi contractual right to recover money on that ground, it is, generally speaking, not the promise which is referred to as the consideration, but the performance of the promise, and if performance failed, the inducement which brought about the payment of money is not fulfilled.

As the decision in *Fibrosa's case* applied only to cases of total failure of consideration, and did not resolve all the difficult problems resulting from frustration of a contract, the Law Reform

(Frustrated Contracts) Act 1943 was passed, which gave general effect to the recommendations of the Law Reform Committee. It may be noted that the said Act applies only to contracts governed by English Law which have become impossible of performance, or otherwise frustrated on or after 1st July 1943, and it does not apply to cases where the contract is discharged for other reasons. The Act has confirmed the reversal of the rule in *Chandler v. Webster*, by the *Fibrosa's case*, and more than that it enables the Court, so far as it thinks fit, to set off the payee's expenses against the payer's claim. The Act excludes certain classes of contracts from its operation.

According to Sec. 65 of the Contract Act, where the agreement is discovered to be void, or becomes void, the person receiving any benefit under that contract must refund the same or pay compensation. Therefore according to this rule there is practically no distinction drawn between obligations which become due prior, or subsequent to the date of frustration. In either case, the money already paid under such a contract should be refunded, and the money still to be paid need not be paid. If *Chandler v. Webster* were to be decided according to the Indian Law, the suit for £100 will have to be decreed and the counter claim for £40 should be dismissed, a result which would now follow even in England, on account of the decision in *Fibrosa's case*, and the Law Reform (Frustrated Contracts) Act 1943.

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## CHAPTER XIII

### QUASI CONTRACTS, OR RELATIONS RESEMBLING THOSE CREATED BY CONTRACT.

Relations or obligations resembling those created by contract are also called Implied Contracts, or Quasi Contracts, or Constructive Contracts. A quasi contract is only a creation of lawyers and judges, based on certain equitable considerations. These obligations could neither be referred as tortious nor contractual, but yet are recognised as enforceable in Courts. Hence they are called quasi contracts.

The principle underlying quasi contracts is that no one shall be allowed unjustly to enrich himself at the expense of another, and the claim based on quasi contracts is generally for money. There is no correct definition of a quasi contract given anywhere (including the Indian Contract Act). But those given by Dr. Winfield and Dr. Jenks may be accepted in the absence of a better one. Dr. Winfield defines quasi contract as: "a liability not exclusively referable to any other head of law imposed on a particular person to pay money to another, on the ground of unjust benefit." Dr. Jenks defines it as a situation in which "law imposes upon one person, on grounds of natural justice, an obligation similar to that which arises from a true contract, although no contract express or implied has in fact been entered into by them." If a trader A supplies goods to his customer B, and he receives and consumes them, the obligation of B to pay the price arises from his promise implied by his conduct, though the promise is not expressed in writing or by spoken words. This kind of contract is called a *tacit contract*. In the very same illustration, if the goods are delivered by a servant of A to C, mistaking C for B, then C will be bound to pay compensation to A for their value. This is a *quasi contract* or an *implied contract* because there is not even a semblance of a promise by B. It need hardly be said that the law of quasi contract is of recent origin, and is still capable of further development.

The following are the principal cases of quasi contracts :—

I Action for money had and received.

- II *Quantum meruit.*
- III Accounts stated.
- IV Necessaries supplied to a person incapable of contracting.
- V Obligations of a finder of goods.

I. *Action for money had and received.*—This action may be available in any of the following cases :

1. *Where money is paid by the plaintiff to the defendant.*—which the former seeks to recover. This again may arise in any of the following cases :—

- (i) Where money is paid by mistake.
- (ii) Where money is paid to the defendant in pursuance of a contract, the consideration for which has failed.
- (iii) Where money is obtained from the plaintiff by the defendant by practising coercion, fraud, or other unfair means.

In all these cases it is but just, that the defendant should be compelled to return or refund the advantage which he obtained.

The Indian Law is contained in Secs 64, 65 and 72 of the Contract Act. Sec. 72 reads as follows :—

“ A person to whom money has been paid, or anything delivered by mistake or under coercion must repay or return it.”

Sec. 65 of the Contract Act, already referred to, compels a person, whether he be a promisor or promisee, who receives a benefit under a void contract, to compensate the other party from whom such benefit has been received. Sec. 64, lays down that a party rescinding a voidable contract shall, if he has received any benefit thereunder from the other party to such contract, restore such benefit, so far as it may be, to the person from whom it was received.

In *Muralidhar Chatterjee v. International Film Co., Ltd.* (1943) 2 M. L. J. 369 (P. C.) it was held that a party to a contract who had elected to put an end to it under Sec. 39, on account of the wrongful repudiation of the contract by the other party, was bound under Sec. 64 to return any benefit he had received under the contract, but that he will be entitled to claim damages for the defaulting party's breach. It was also held that the words



'benefit' and 'advantage' under Secs. 64 and 65 do not refer to any question of 'profit' or 'clear profit', nor would it matter what the party receiving the money may have done with it.

Where in a suit on a mortgage it was found that the mortgage was invalid as being in contravention of Schedule 3 paragraph 11 C.P.C., the mortgagee was held entitled to claim compensation under this section. *Raja Mohan Manchan & others v. Manzoor Ahmad Khan & others.* (1943) 1 M.L.J. 508 (P. C.)

2. *Money paid by plaintiff for the use of the defendant.*— This occurs when A pays money which B is liable to pay, at the implied request of B, *e.g.*, where a tenant A pays taxes due from his landlord B in order to prevent the land in his (tenant's) possession from being proceeded against in execution; or when A's property is lawfully taken in execution of B's debt. In such cases there is an obligation on B, the party benefitted, to repay the amount paid for his benefit. In India the scope of liability is wider than in England, and it is expressed in Secs. 69 and 70 Contract Act.

Sec. 69, reads as follows :—

"A person who is interested in the payment of money which another is bound by law to pay, and therefore pays it, is entitled to be reimbursed by the other."

In order that the section may apply it is necessary to prove that:

(i) the person making the payment is interested in the payment of money *i.e.*, the payment was made bonafide, for the protection of his own interest *e.g.*, A purchasing property from B bonafide, can recover from B money paid to save the property from being sold in execution of a decree obtained against B. *Subrahmanya Iyer v. Rangappa*, 33 Mad. 232.

(ii) The payment should not be a voluntary payment. It should be such that there is an obligation express or implied to repay *i.e.*, there must be some legal or other coercive process compelling the payment. *Ram Tuhai Singh v. Biseswar Lal*, (1875) 2 I. A. 131 (P. C.)

(iii) The payment must be to another person.

(iv) The payment must be one which the other party was bound by law to pay, whether it is personal, or one attached to the lands held, by him. The Madras High Court in *Jagapatiraju v. Sadrusannamma Ayad*, 39 Mad. 795, and the Calcutta High

Court in *Manindra v. Jamahir*, 32 Cal. 643, and *Biraj Krishna v. Purnachandra*, I. L. R. (1939) 2 Cal. 226, held that Sec. 69, does not apply to suits for contribution, *i.e.*, to cases where both plaintiff and defendant are liable for the money paid by the plaintiff.

Sec. 70, Contract Act, lays down as follows :—

“Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or restore, the thing so done or delivered.”

In order to invoke Sec. 70, the following conditions must be satisfied : (1) the thing must be done lawfully ; (2) it must be done by a person not intending to act gratuitously ; and (3) the person for whom the act is done must enjoy the benefit of it. Thus in *Sriramaraju v. Secretary of State*, (1942) 2 M. L. J. 800 (F. B.) where the Government affected repairs to an irrigation tank owned by the Government jointly with a shortriemdar, and sued the shrotriemdar for contribution in respect of expenses incurred for the repairs, it was held that the Government in carrying out the repairs had acted lawfully, and had not intended to carry them out gratuitously and that the shortriemdar who enjoyed the benefit of the repairs, was liable to pay contribution under Sec. 70 of the Contract Act. It was also held that according to English law he would not be liable, but that the provisions of Sec. 70, are wider than the English law.

3. *Money obtained by defendant from third parties on plaintiff's account.*—Where an agent obtains money by way of secret commission, or by practising fraud and abusing his position as an agent, he will be bound to make good the amount to the principal, though the agent was not authorised to collect the same, on the ground that the payment to the agent was made for the use of the principal.

II. *Quantum Meruit.*—*Quantum Meruit* is the name given to an action distinct from that arising out of the original contract, and based upon a new contract originating in the conduct of the parties. It is available for example when a person has partly performed his obligation and is prevented from completing it on account of the default of the other. *Cutter v. Powell*, (1795) 6 T.R. 320. This expression *quantum meruit* is only used when the part performance relates to the services of an individual, while *quantum*

*valebant* is the expression used in cases where there is part delivery of goods. This principle relating to *quantum meruit* is often applied in cases of contracts entered into with corporations which are not binding on them, because of the absence of a seal, or the directors not being competent or qualified etc., but the corporation had the benefit of the services under the contract. *Craven Ellis v. Cannons Ltd.*, (1936) 2 K. B. 403. In those cases though the party rendering services or delivering goods to the corporation may not recover anything under the contract, yet on principles of equity, the action of *quantum meruit* or *quantum valebant* would be made available to that party, and the corporation will be compelled to compensate him. *Palaniswami Gounder v. E & S Co-operative Societies*, A.I.R. 1933 Mad. 145. The action of *quantum meruit* is allowed in Indian Courts under S. 70 of the Contract Act.

III. *Accounts Stated*.—This is a form of action known to the English Law, where the obligation arises from an admission of indebtedness from which the law may imply an undertaking to pay e.g., an I. O. U. (I owe you). Thus where the balance has been struck in an account, an action can be brought thereon without going into all the transactions which led up to it.

IV. *Necessaries supplied to persons who have no capacity to contract*.—This topic has been already referred to, and it is sufficient to note that if an infant, or a lunatic, or his dependent is supplied with necessaries of life, an obligation would be created whereby the estate of the minor or lunatic, as the case may be, would be bound to compensate the trader who supplied them. This is on the basis of quasi contract. The Indian Law is contained in S. 68, Contract Act, already referred to.

V. *Obligation of a finder of goods*.—Ordinarily speaking, a person is not bound to take care of goods, belonging to another left on a road or other public place, by accident or inadvertence, but if a person however takes them into his custody, he will be in the position of a bailee, and will be bound to take care of them and return them in the same good condition as if he is a bailee (*infra*). This obligation is imposed on the basis of a quasi contract.

Sec. 71 of the Contract Act reads thus :—

“A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee.”



## CHAPTER XIV

### REMEDIES FOR BREACH OF CONTRACT

The remedies available in cases of breach of contract are, broadly speaking, of two kinds :—

1. Common Law remedy, *viz.*, damages.
2. Equitable remedy, *viz.*, Specific performance of contracts, injunction, rectification, cancellation, etc.

A study of the law applicable to the Equitable remedy is not within our province. It is necessary to know something about the common law remedy of damages. The principle on which damages are awarded for breach of contract has been stated as follows : “ The rule of the common law is that where a party sustains loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation with respect to damages, as if the contract had been performed.” The remedy of damages therefore only tries to evaluate in terms of money, the loss which a party sustains as a result of breach of contract. It need hardly be said that money is not always an adequate remedy for a breach of contract; but bearing in mind that the equitable remedy of specific performance is not available in every case, and is subject to several limitations, there is no other alternative for Courts than to award damages which, of course, is available in every case. Another important point which should be noted is that the measure of damages is the value of performance of the contract to the plaintiff, and not what it costs the defendant to perform it.

Damages, generally speaking, are of four kinds :—

1. General, or ordinary, or substantial, damages.
2. Special damages.
3. Vindictive, or punitive, or exemplary, damages; and
4. Nominal damages.

1. *Ordinary damages*.—The principle on which ordinary damages, as distinct from special damages, are awarded is that ordinary damages would be awarded only for consequences

naturally flowing out of the breach, or as they are called, the proximate consequences. In the case of a breach of contract for delivery of goods, the measure of damages is the difference between the contract price, and the market price. Thus if A agrees to deliver 100 bags of rice at Rs. 10 a bag, on a future date and finding that the market on that date had risen to Rs. 11 a bag, he refuses to deliver them, the measure of damages is the difference between the market price on the date of breach, and the contract price *viz.*, Rs. 100. If the goods are of a quality which can ordinarily be had in the market, the court will only award damages, but would not decree specific performance, which would only be granted if the article is of a very rare quality, and is not ordinarily available. In contracts for the payment of money on a particular date, the measure of damages, in case of default, is represented by the sum consisting of the principal, together with interest at the ordinary market rate. Under the heading of general damages, damages for personal inconvenience can be granted, but not damages remotely connected with the breach of contract. In one case, the plaintiff's wife, a railway passenger caught cold and fell ill due to her being asked to get down at a place other than the Railway station. In a suit by the plaintiff against the railway company : held that damages for the personal inconvenience of the plaintiff alone could be granted, but not for the sickness of plaintiff's wife, because it was a very remote consequence. Damages for mental distress would not ordinarily be granted for breach of a contract, except in cases of contract to marry.

2. *Special damages*.—The rule governing special damages is considered below, and these damages are claimed in cases of loss of profit etc., *e.g.*, where the purchaser on the strength of a contract for sale of goods, enters into a contract at a higher price for their resale. In these cases the loss arises not in the usual course as a natural consequence, but on account of the unusual or extra-ordinary circumstances of the case.

3. *Vindictive damages*.—They are awarded with a view to punish the defendant, and not solely with the idea of awarding compensation to the plaintiff. As a rule vindictive damages would not be granted in cases of contract, but will generally be awarded in actions on tort. But the exceptions to this rule are the following: (i) Breach of promise to marry; (ii) Breach of contract by a

banker possessing the funds of the customer, to honour his cheque. The rule in the latter kind of cases is, the smaller the cheque the greater the insult.

*Nominal damages.*—They are awarded in cases of breach of contract where there is only a technical violation of the legal right, but no substantial loss is caused thereby. The damages granted in such cases are called nominal, because they may be 1 anna or 1 pie, which may only have a nominal existence, but no existence in point of quantity.

The English Law on the question of damages is laid down in the famous case of *Hadley v. Baxendale*, (1854) 9 Ex. 341. In this case the plaintiff, an owner of a mill, entrusted a part of the machinery to the defendant, a common carrier, for sending it for repairs. The defendant was not made aware that for want of that part the whole mill would remain idle. There being extraordinary delay in delivering the machine-part, plaintiff filed a suit claiming damages not only for the delay in delivering it, but also for the loss of profits caused by the mill remaining idle. It was held that damages on the first count could be awarded, but not those for loss of profits because they constituted special damages, and the probability of its occurrence was not in the contemplation of both the parties at the time of contracting.

The rules applicable to award of damages for breach of contract may be stated as follows :

1. The injured party is to be placed in the same financial position as if the contract had been performed.

2. Damages which may fairly and reasonably be considered as fairly and naturally arising from the breach, can be recovered. (*Hadley v. Baxendale*.)

3. Damages which may reasonably be supposed to be in the contemplation of the parties, at the time of entering into the contract, as the probable result of the breach, though not naturally arising out of the breach, can be recovered, *Pinnock Bros. v. Lewis Peat Ltd.* (1923) 1 K. B. 690.

4. Damages which do not fall under 2 or 3 above, but are the result of special circumstances peculiar to that case, called *special damages*, are not recoverable, unless the special circumstances are brought to the notice of the other party before the contract is made. (*Hadley v. Baxendale*.)

In *Simpson v. London and North Western Railway Company*, (1876) 1 Q. B. D. 274, the plaintiff, dealing in cattle foods, sent samples by train for being exhibited at a particular agricultural show, which fact was made known to the railway company. The goods reached the destination after the show was over. Held that the special circumstances having been brought to the notice of the Railway Company, it must be deemed that the special damages, namely loss of profits, were in the contemplation of the parties at the time of entering into the contract to be the natural consequence of the breach, and that they were recoverable.

5. It is the duty of the injured party to minimise damages. *British Westinghouse & Coy. v. Underground Electric etc., Coy.*, (1912) A.C. 673; and *Jamal v. Mulla Dawood & Son*, 43 Cal. 493 (P.C.)

6. If the parties agree about the damages, for breach of contract, no more than the agreed amount can be recovered. *Cellulose Acetate Silk Coy. v. Widnes Foundry*. (1933) A. C. 20.

7. The injured party is not disentitled to damages because it is difficult to assess them.

8. Vindictive or exemplary damages cannot be awarded for breach of contract except for breach of contract of marriage. *Addis v. Gramophone Coy.* (1909) A. C. 488,

Indian Law is the same as the English Law, and is laid down in Sec. 73, Contract Act, as follows :—

“ When a contract has been broken, the person who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of breach.

When an obligation resembling those created by a contract has been incurred and has not been discharged, any person receiving injury by the failure to discharge it, is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.

*Explanation.*—In estimating the loss or damages arising from a breach of contract, the means which existed of remedy-

ing the inconvenience caused by the non-performance of the contract must be taken into account."

The section makes it clear that the compensation available in the case of a quasi contract, is the same as damages that would be awarded if that quasi contract were a contract.

*Penalty and Liquidated damages.*—The distinction between penalty and liquidated damages has been stated in *Dunlop Pneumatic Tyre & Co. v. New Garage and Motor Co.*, (1915) A. C. 79, thus :—

"The essence of a *penalty* is a payment of money stipulated as '*in terrorem*' of the offending party : the essence of *liquidated damages* is a genuine covenanted pre-estimate of damage."

Thus a term in a contract amounts to a *penalty* where a sum of money, which is out of all proportion to the loss, is stipulated as payable in case of its breach; and penalty is not recoverable. For example a term that in case Rs. 100 are not to be paid on a particular date, Rs. 200 should be paid, is a stipulation amounting to penalty, and is not recoverable. It is obvious that the effect of this penal term is to terrorise the other party, and compel him to perform the original promise. *Liquidated damages* on the other hand is the sum fixed by way of damages by the parties at the time of the contract itself, without leaving them to be determined by the Court. Thus for instance where a building contractor agrees to deliver a building after construction to a company, to enable it to start a mill, and in the event of his failure to do so the contractor should pay Rs. 100 for every day's delay, the stipulation amounts only to liquidated damages, because no Court can, with any degree of certainty, calculate the loss suffered by the company in the event of the delay; and it is therefore recoverable. The fact that the consequences of the breach make an accurate pre-estimation of damages impossible, does not prevent the sum from being liquidated damages.

Thus while a stipulation in the nature of penalty is un-enforceable, stipulation in the nature of liquidated damages is enforceable. But the rule for determining whether a stipulation amounts to a penalty or liquidated damages, is far from simple, and has to be determined from the circumstances of each case, as well as the language used. The other rules, for distinguishing the two, are



peculiar to English Law, and are not therefore dealt with here. Indian Law is different from the English Law, and is very simple in practice, and is laid down in S. 74, Contract Act as follows :--

- (i) When a contract has been broken, and a sum is named in it as the amount to be paid in case of its breach either by way of penalty or liquidated damages, the party complaining of the breach is entitled to a reasonable compensation, whether or not actual loss is proved;
  - (ii) In either case it is only reasonable compensation that will be allowed, and the entire amount will not be decreed, even though the term amounts to liquidated damages;
  - (iii) Stipulations providing for enhanced rate of interest from the date of default of payment of the principal, or annual interest, are in the nature of a penalty. It is on this principle that Courts in India do not allow compound interest at a rate higher than the original rate of interest, though stipulated in the bond;
  - (iv) Bail bonds and other similar instruments for performance of a public duty in favour of the Government, though containing stipulations amounting to penalty, will be enforced, and the entire sum mentioned therein will have to be paid;
  - (v) Whether a bond executed in favour of the Government is for performance of public duty, or not, has to be determined upon the construction of that bond.
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## CHAPTER XV

### CONTRACT OF INDEMNITY AND GUARANTEE

Chapter VIII of the Indian Contract Act (Secs. 124 to 147) deals with the law relating to Indemnity and Guarantee.

*Contract of Indemnity defined* : Section 124 enacts thus :

“ A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a ‘ contract of indemnity ’.”

For example if A contracts to indemnify B against the consequences of any proceedings, which C may take against B in respect of a certain sum of Rs. 500, it is a contract of indemnity. Similarly if A promises not to construct buildings on a particular site preventing light and air to B’s house, and to protect B from any loss resulting from a violation of that promise, he will be entering into a contract of indemnity. It has already been mentioned that a contract of insurance is a contract of indemnity.

In English Law, ‘ indemnity ’ is defined as a “ promise to save another harmless from the loss caused as a result of a transaction entered into at the instance of the promisor.” Thus in contracts of indemnity the liability of the promisor is a contingency, the contingency being the conduct of a third person or the promisor himself, or even an Act of God.

The definition of indemnity in English Law is much wider than the definition in Indian Law in that the former includes promises to save a person harmless from loss resulting not only from the conduct of the promisor or a third person, but also from loss caused by events or accidents like death, disability, destruction by fire, etc., cyclone, which do not depend on the conduct of any human being. Sec. 124 does not in terms cover promises relating to losses arising from such accidents. Further Secs. 124 and 125 deal only with express promises of indemnity. But a duty to indemnify may also be annexed by operation of law, e.g., the duty of a principal to indemnify an agent from consequences of all lawful acts done by him as an agent (Sec. 222).

*Definition of Contract of Guarantee* :—According to the Act:

"A contract of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called 'the surety,' the person in respect of whose default the guarantee is given is called the principal debtor, and the person to whom the guarantee is given is called his 'creditor'. A guarantee may be either oral or written." (Sec. 126).

**In English Law it is defined as :**

"One in which a person undertakes to be answerable to another for the payment of a debt or the performance of some act on the part of a third person."

Thus if A and B enter a trader's shop, and A says to the trader, "supply the articles required to B, and if he does not pay you, I will", it is a contract of guarantee, the primary liability being with B and secondary liability with A. On the other hand if A says to the trader, "let him (B) have the goods, I will see you paid", the contract is one of indemnity. *Birkmyr v. Darnell*. (1704) 1 Salk 27. The person giving the indemnity (A) is primarily liable, and there is no secondary liability.

The following are the points of difference between a contract of indemnity and a contract of guarantee :—

#### CONTRACT OF INDEMNITY

1. There are only two parties to it viz., the indemnifier (promisor) and the indemnified (promisee).
2. Even according to the Statute of Frauds it need not be in writing.
3. The promise of the indemnifier is to save the indemnified from a contingent risk.
4. Once the risk takes place, the indemnifier is the only person liable.
5. In cases where the promisor indemnifies the promisee from risk arising from the conduct of a third person, the indemnifier cannot, even after paying the indemnified, sue those third parties in his own name, unless there is an assignment of the right from the indemnified (*Periamanna Marakkayar v. Banians & Co.*, 49 Mad. 156).

#### CONTRACT OF GUARANTEE

1. There are three parties to it viz. the principal debtor, the surety and the creditor.
2. According to the Statute of Frauds it should be in writing.
3. The surety undertakes to discharge the liability of the principal debtor which is not contingent, but is a subsisting one.
4. The promise of the surety is only a collateral undertaking and he will not be liable till the principal debtor commits default.
5. The surety can, after paying the creditor, sue the principal debtor for reimbursement in his (surety's) own name.

**Rights of the Indemnified (Indemnity holder) :** Section 125 lays down that in cases where the indemnified had to institute

or defend any suit (without contravening the promisor's orders, or in pursuance of such orders) he can recover the following sums from the indemnifier :

- (1) All damages, which he may be compelled to pay in any suit, in respect of any matter to which the promise to indemnify applies. .
- (2) All costs, which he may be compelled to pay in any such suit, if he acted as a prudent person.
- (3) All sums, which he may have paid under the terms of any compromise of any suit, if the compromise is one prudent for the promisee to make in the absence of any contract of indemnity.

*In Gajanan Moreswar v. Moreswar Madan* I.L.R. 1942 Bom. 670 it was observed that Secs. 124 and 125 of the Contract Act are not exhaustive of the law of Indemnity, and that the Indian Courts would apply the same equitable principles as in England. Following the English law it was held that when a person contracts to indemnify another, and the indemnified has incurred an absolute liability, he can, even without suffering actual loss, call upon the indemnifier to place him in a position to meet the liability that may be cast upon him. The High Courts at Madras, Allahabad and Calcutta are of the same view. But the Lahore High Court, and the Bombay High Court in some other cases have taken a contrary view.

*Some Features of the Contract of Guarantee or Suretyship :—*

A contract of suretyship, being essentially a contract, has to fulfil the requirements of a valid contract. But it has got certain peculiar features of its own. For instance, it is not necessary to support a contract of suretyship that the creditor should furnish any consideration with respect to the surety, in addition to the consideration furnished to the principal debtor. Thus Sec. 127 enacts :

“ Anything done, or any promise made, for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee.”

Thus if A requests B to lend Rs. 500, and B agrees to do so provided C guarantees its repayment, and C guarantees, then the advance of Rs. 500, which supports the promise of A is also sufficient consideration for C's promise. In other words the detriment suffered by B, in lending A at C's request is sufficient consideration for C's promise. But where the promise of C is subsequent to the contract between the creditor B and the principal debtor A, there must be some extra-consideration to support it, *e.g.*

forbearance to sue, reduction of interest, etc., and the same old consideration between A and B will not suffice.

A contract of suretyship is not a contract "*uberrimae fidei*" i.e., one requiring complete disclosure of all material facts by the principal debtor, or the creditor, to the surety before the contract is entered into by him. Thus when a guarantee is given to a bank it is under no obligation to inform the surety of matters affecting the credit of the debtor, or of any circumstances connected with the transaction, which render the position of the surety more onerous. But if the guarantee is in the nature of an insurance e.g., a fidelity guarantee, all material facts must be disclosed, otherwise the surety can avoid the contract. *London General Omnibus Coy v. Holloway* (1912) 2 K. B. 72.

Further the contract between a creditor and a surety being a collateral undertaking to discharge the principal debtor's liability, the surety will not be discharged from liability even though the promise of the principal debtor is void on the ground of his incapacity to contract, or as being *ultra vires* his powers. The promise of the surety in such cases will be the principal contract and will be perfectly valid and enforceable. *Kashiba v. Sripat* (1895) 19 Bom. 697. Similarly the discharge of a principal debtor brought about by the operation of an Act subsequently passed, would not discharge the surety. *Subrahmanyam v. Batcha Rowther* (1941) 2 M.L.J. 75.

The liability of a surety, as already stated, is secondary, and it arises only after default is committed by the principal debtor. It is not however necessary that notice of default should be given to the surety, unless it was expressly agreed to be given. Nor is it necessary for the creditor to request the debtor to pay, nor to sue him, before he (creditor) can proceed against the surety, unless it was so expressly agreed between the creditor and the surety. The creditor must however strictly comply with the terms of the contract of guarantee, and as we shall presently see, if he varies the terms of the contract, without the consent of the surety, he will be released from liability. Hence a surety is sometimes called a "favoured debtor", meaning thereby that the least blame on the part of the creditor may exonerate the surety from his liability.

Since a principal debtor and his surety are two distinct persons, an admission or acknowledgment by the principal debtor would not extend the period of limitation against the surety. Similarly a decree obtained against the principal debtor alone cannot be executed against the surety.

*Continuing Guarantee* :—A guarantee may be in respect of a single transaction, or in respect of a number of transactions, when it is called a 'continuing guarantee'. Whether it is such a guarantee or not depends on the language of the document, the subject-matter of the contract, and the surrounding circumstances. Sec. 129 defines a continuing guarantee as "a guarantee which extends to a series of transactions." Thus if A, in consideration of B employing C in collecting the rents of B's estate, promises B to be responsible to the extent of Rs. 5,000, for the due collection and payment by C of those rents, it is a contract of continuing guarantee. A continuing guarantee may be terminated as to future transactions in the following ways :—(1) By revocation *i. e.*, by giving notice of the same to the creditor. (Sec. 130). (2) By death of the surety, in the absence of a contract to the contrary. (Section 131).

*Difference between a guarantee for a part of the whole debt, and a guarantee for the whole debt subject to a limit* :—It is a question of intention of the parties, whether a guarantee is for the whole debt subject to a limit, or for part of the debt only. The leading case of *Ellis v. Emanuel*, (1876) 1 Ex. Div, 157, lays down that in the case of a floating balance, if a guarantee is given only for a portion thereof, it must be construed *prima facie* as applicable to a part of the debt only; but if the liability, in respect of a portion of which the guarantee is given, is a fixed and ascertained sum, then, *prima facie* the contract of guarantee should be construed as one for the whole debt subject to that limit. These rules are subject to variation by a contract between the parties. Thus by means of an express contract a surety can, even in the case of a floating balance, hold himself liable for the whole debt, subject to a limit. In that kind of guarantee the creditor can in case of the principal debtor's bankruptcy, prove for the whole debt, without any deduction of the amount realised from the surety, and the surety will not be entitled to stand in the creditor's shoes, until the entire debt of the creditor has been paid. It is not so in the case

of a guarantee for a part of a debt. The difference between these two kinds of guarantee is therefore of far-reaching consequence.

To take an illustration, if B owes A Rs. 5,000 and C has stood surety for Rs. 3,000, a question may arise whether C guarantees only Rs. 3,000 out of Rs. 5,000 or the full amount of Rs. 5,000 subject to the limit of Rs. 3,000. If C's promise is construed as guarantee only for part of the debt, and B's estate in insolvency can only permit a dividend of four annas in the rupee, A can get Rs. 3,000 from C and Rs. 500 from B's estate, while C can claim Rs. 750 from B's estate. If on the other hand the promise of C is construed as a guarantee for the whole debt subject to the limit of Rs. 3,000, then, A can recover from C Rs. 3,000 and from B's estate a dividend on the entire sum of Rs. 5,000 *viz.*, Rs. 1,250, and C cannot claim any dividend unless and until A has been fully paid, which can happen only if B's estate permits a dividend of Rs. 0-6-5 or more in a rupee to be declared.

*Rights of surety against creditor* :—According to English Law if there are two joint promisors, and one of them is the surety, and the other the principal debtor, and the promisee has notice of that fact, the person who is not the principal debtor is entitled to all the rights of a surety against the creditor. This is the principle laid down in *Rouse v. Bradford Banking Co.*, (1894) A. C. 586. Section 132, which was enacted prior to that decision, lays down a contrary rule. According to it if A and B, execute a joint money bond in favour of C, and even if C knows that according to the contract between A and B, A is the principal debtor and that B is his (A's) surety, still C may proceed against B, as if he is also a principal debtor, B cannot claim any of the privileges of a surety, because according to Indian Law mere knowledge of the creditor is not enough, but there should be an agreement between the surety and the creditor, whereby the latter agrees to make the former liable only in the event of a default by the principal debtor. Where there is such a contract between the creditor and the surety, he will be entitled as in English Law to the following rights against the creditor :—

1. After the guaranteed debt has become due, and before the surety is called upon to pay, he may require the creditor to sue the debtor and collect the amount. *Rouse v. Bradford Banking Coy.*, (*supra*). But the surety must undertake to indemnify the creditor for any risk, delay, or expense, resulting therefrom. The surety cannot compel the creditor to sue the principal debtor before suing him (surety).

2. In cases of guarantee regarding good conduct, honesty etc., of the principal debtor (known as *fidelity guarantees*) the surety can, in case of established dishonesty of the principal debtor, insist upon the creditor terminating his (principal debtor's) services, and thus protect himself (surety) from future losses.

3. The surety when sued, can claim any set off, or counter claim, which the principal debtor could have claimed against the creditor.

4. The surety can after payment of the guaranteed debt require the creditor to assign to him all the securities held by the creditor in respect of the debt.

*Rights of surety against the principal debtor* :—1. Soon after making a payment and discharging the liability of the principal debtor, the surety is clothed with all the rights of the creditor which he can himself exercise against the principal debtor. This right of the surety is called 'subrogation.' Sec. 140, lays down :

"Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor."

It may be noted that there must be a payment or performance, and not a mere promise to pay, and such payment or performance should be of the entire debt or liability and not a part of it, before the right of subrogation can be claimed.

2. The surety, on payment, is entitled to proceed against such of the securities of the principal debtor, as the creditor himself could proceed against. Sec. 141 enacts:

"A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security."

According to English Law, subsequent securities, *i.e.*, securities taken by the creditor subsequent to the contract of guarantee, are also available to the surety. But as the section stands they do not appear to be available to a surety in India. This difference however seems to be an inadvertent error in the codification rather, than an intentional departure from the English Law.



3. A surety is entitled to be indemnified against all payments properly made by him.

“In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety ; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee ; but not sums which he has paid wrongfully.” (Sec. 145).

4. A surety can, even before making any payment, compel the debtor to relieve him from liability by paying off the debt, provided the liability is an ascertained and subsisting one.

*Rights of a surety against co-sureties* :—1. As already noticed, equity would not tolerate one co-surety being compelled to pay the entire debt of the principal debtor, when there are other co-sureties. In such cases, on the basis of a quasi-contract, the surety can claim contribution for the excess amount paid by him. If the principal debtor becomes insolvent, the loss has to be borne by all the sureties equally, and the right of contribution will be available, if one of the sureties is obliged to bear the entire loss in the first instance.

“Where two or more persons are co-sureties for the same debt or duty, either jointly or severally, and whether under the same or different contracts, and whether with or without the knowledge of each other, the co-sureties, in the absence of a contract to the contrary, are liable as between themselves, to pay each an equal share of the whole debt, or of that part of it, which remains unpaid by the principal debtor.” (Sec. 146).

2. Where however the co-sureties have agreed to become liable in different sums, according to English Law, they are bound to contribute proportionately. But according to Indian Law they should contribute equally, but not exceeding the sums which they have agreed to pay :—

“Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.” (Sec. 147)

Thus if A and B are two sureties for the liability of C, and A agrees to be liable to the extent of Rs. 1,000, and B to the extent of Rs. 2,000 and if C's indebtedness, which they are called upon to pay is Rs. 1,500, according to Indian Law, A will have to pay Rs. 750, and B will have to pay Rs. 750. But according to English Law, A will have to pay Rs. 500 and B will have to pay Rs. 1,000.

*Cases in which a surety is discharged* :—In the following cases a surety will be discharged from liability. Broadly speaking these cases fall under three headings :—

I. Where the contract of suretyship is void, or voidable, on account of some defect in the contract.

II. Where the suretyship is revoked.

III. Where the creditor is guilty of improper conduct.

1. *Where the contract of suretyship is void or voidable* :—In the following cases contract of suretyship is void, or voidable at the instance of the surety:

- (a) When the guarantee has been obtained by misrepresentation made by the creditor or with his knowledge and assent, concerning a material part of the transaction. (Sec. 142).
- (b) Where the guarantee is obtained by keeping silence as to material circumstances. (Sec. 143).
- (c) Where the guarantee is given upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety and such person has not joined (Sec. 144).

II. *Where the suretyship is revoked* :—Where the suretyship relates to a single transaction and the liability has been incurred, a surety cannot revoke the guarantee. But in the case of a continuing guarantee, revocation is possible with regard to future transactions. (*supra*).

III. *Where the creditor is guilty of improper conduct* :—Since a surety is a favoured debtor, if the creditor is guilty of any improper conduct, the surety will be discharged, as in the following cases :

(a) Where the terms of the contract between the principal debtor and the creditor are varied by the creditor without the consent of the surety (Sec. 133).

In *Pratap Singh v. Keshavlal* 59 Bom. 180 (P.C.), the guaranteed transaction was an advance of certain amount by the creditor on the security of four properties of the principal debtor, but the transaction as carried out was an advance of a lesser amount on the security of only three properties. It was held that the final obligation of the principal debtor was something different from the obligation which the surety guaranteed, and that the surety was therefore discharged from liability.

(b) Where a contract is entered into between the creditor and the principal debtor by which the principal debtor is released, or any act or omission is made by the creditor having the effect of discharging the debtor (Sec. 134). But mere forbearance on the part

of the creditor to sue the principal debtor, or to enforce any remedy against him, does not, in the absence of a contract to the contrary, discharge the surety (Sec. 137). The bankruptcy of the debtor and his subsequent discharge, would not release the surety, as it is not attributable to any act or omission of the creditor.

(c) Where a contract is entered into between the creditor and the principal debtor by which the creditor makes (i) composition with, or (ii) promises to give time to, or (iii) not to sue the principal debtor (Sec. 135). It must however be noted that a promise by the creditor to a third person, to give time to the principal debtor, would not discharge the surety (Sec. 136).

(d) Where the creditor, without the consent of the surety, loses or parts with the securities belonging to the principal debtor (Sec. 141.)

(e) Where the creditor does any act inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do. (Sec. 139). For example, if A introduces M as an apprentice to B, and A guarantees M's fidelity, and B promises in his turn to verify the cash and check the accounts, but B omits to do so and M embezzles, A will not be liable on his contract of suretyship.



## CHAPTER XVI

### BAILMENTS

The law relating to bailments is dealt with in Chapter IX (Secs. 148 to 181) of the Indian Contract Act. *Bailment* is defined in Halsbury's Laws of England as "a delivery of personal chattels in trust, on a contract express or implied, that the trust shall be duly executed, and the chattels re-delivered, in either their original or altered form, as soon as the time of use for, or condition on which they were bailed, shall have elapsed, or been performed." Section 148, defines a bailment thus :

"A bailment is

- (1) the delivery of goods ;
- (2) by one person (called the bailor) to another (called the bailee);
- (3) for some specific purpose ;
- (4) upon a contract that they shall, when the purpose is accomplished, be returned or otherwise disposed of, according to the directions of the person delivering them."

The most common illustration of a contract of bailment is where a watch is given for repairs, or diamonds are given for being set in a gold ring. In both these cases, the identical watch or the identical diamonds, should be returned after the purpose for which they were given has been fulfilled. A pledge of a jewel on the security of which money is borrowed, gold jewels delivered to a bank for safe custody, goods delivered to a railway company, for being carried and delivered to the consignee, are all examples of bailments.

In *Coggs v. Bernard* (1703) 1 Sm. L. C. 175 Lord Holt, Chief Justice, has classified all bailments under six heads:—

- (1) *Depositum*—i.e., delivery of goods for the use of the bailor.
- (2) *Commodatum*—i.e., delivery of goods by way of a gratuitous loan to the bailee.
- (3) *Locatio Rei*—i.e., a loan of goods to the bailee for hire.

- (4) *Vadium*—i.e., pawn or pledge.
- (5) *Locatio operis faciendi*, i.e., delivery of goods for being transported, or something to be done about them by the bailee for reward.
- (6) *Mandatum*—i.e., same as *Locatio operis faciendi* but without any reward.

The Contract Act deals with the general principles underlying a contract of bailment, and some special types of bailments e.g., pledges and finder of lost goods. The rest are dealt with by separate Acts e.g. Carriers Act, Railways Act, etc. In a contract of bailment generally there will be consideration, in the shape of money payment by the bailor, as in the case of watch given for repairs; or by the bailee, as in the case of a contract of hire of furniture etc., but such consideration is unnecessary to support the promise of the bailee to return the goods. The detriment suffered by the bailor, in parting with the possession of goods, is sufficient consideration to support the bailee's promise to return them. Thus even in a gratuitous bailment the bailee cannot disclaim his obligation to return the goods bailed.

*Duties of Bailee* :—The duties of a bailee are as follows :

(1) *To take care of the goods* :—The foremost duty of a bailee is to take care of the goods bailed, and to return them in their original condition, or in a condition altered, as per terms of the contract. During the time the goods are in the bailee's possession, he will be responsible for any loss or damage caused to them on account of his negligence.

According to English Law there are three degrees of negligence, and three degrees of diligence which may be exercised by a bailee, according to the circumstances of each case, but in Indian Law, there is only one uniform standard of diligence, or care, which should be exercised by the bailee, whether the contract be gratuitous or one for reward, viz., the care of a reasonable and prudent man.

Section 151 enacts as follows : —

"In all cases of bailment, the bailee is bound to take as much care of the goods bailed to him as a man of ordinary prudence would under similar circumstances take of his own goods of the same bulk, quality and value of the goods bailed."

### Section 152 lays down :

"The bailee, in the absence of any special contract, is not responsible for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care of it described in Sec. 151."

From these two sections, it is clear that the degree of care is the same in the case of gratuitous as well as non-gratuitous bailments, and that the bailee is not an insurer of the safety of goods, in the absence of a contract to the contrary. To take an illustration, if a diamond ring is kept by its owner for safe custody with another without any reward, the bailee should keep it locked in an iron safe, or some other safe place, but not keep it in his lumber room, simply because it is gratuitous. Similarly if a cow is delivered for safe custody it is sufficient if it is kept in the backyard properly enclosed, and even if it is for reward, no one would expect it to be kept in the drawing room. If after taking reasonable care the goods are lost, *e.g.*, by theft, or destruction by fire, or cyclone, etc., the bailee is not to blame, and the bailor has to bear the loss.

(2) *Goods bailed should not be mixed with other goods:—* Another duty cast upon the bailee is to see that the goods of the bailor are not mixed with the goods of the bailee. The rules governing the subject are contained in Secs. 155-157 and they are as follows :—

"(i) If the bailee, with the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares in the mixture thus produced. (Sec. 155).

(ii) If the bailee, without the consent of the bailor, mixes the goods of the bailor with his own goods and the goods can be separated or divided the property in the goods remains in the parties respectively ; but the bailee is bound to bear the expenses of separation, division, and any damage arising from the mixture. (Sec. 156).

(iii) If the bailee, without the consent of the bailor, mixes the goods with his own goods in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of the goods (Sec. 157)."

(3) *Bailee should not make unauthorised use of the goods bailed:—* Except to the extent that is necessary for carrying out the terms of a contract of bailment, the bailee should not make greater use of the goods bailed. If the goods are used for some unauthorised purpose and are damaged, or lost, during such use

the bailee will be held responsible, notwithstanding his exercising reasonable care, because while making an unauthorised use, he becomes liable as an insurer. Further if an unauthorised use is made, the contract is liable to be terminated by the bailor. Section 153, lays down :—

“ A contract of bailment is voidable at the option of the bailor, if the bailee does any act with regard to the goods bailed, inconsistent with the condition of the bailment.”

(4) *Bailee should return the goods bailed*:—After the purpose of the contract is furnished the bailee should return the goods bailed to the bailor ; otherwise the bailee will be liable in damages for the loss occasioned by the delay and will be liable during such period as an insurer. Section 160, lays down :

“ It is the duty of the bailee to return or deliver according to the bailor's directions the goods bailed without demand, as soon as the time for which they were bailed has expired or the purpose for which they were bailed has been accomplished.”

Where the bailee is in possession of an article bailed for his benefit *e.g.*, contract of hire, the bailor cannot claim its return earlier than the stipulated period. But in the case of gratuitous bailments, the bailor may require its return even before the purpose for which it was lent has been accomplished. If the bailor compels the return of the article, and such return causes a loss exceeding the benefit conferred by the loan he must indemnify the borrower for the amount in which the loss so occasioned exceeds the benefit so derived. (Sec. 159).

It may be noted that where there are several bailors, the bailee would be discharging his duty, in the absence of a contract to the contrary, if he re-delivers the goods according to the directions of any one joint-owner without the consent of all. (Sec. 165). In the absence of any contract to the contrary, the bailee is bound to deliver to the bailor, or according to his directions, any increase or profit which may have accrued from the goods bailed (Sec. 163). If by the default of the bailee the goods are not returned, delivered or tendered at the proper time, he is responsible to the bailor, for any loss, destruction or deterioration of the goods from that time. (Sec. 161).

#### Duties of bailor

1. *To disclose faults in the goods* :—The bailor should disclose all known defects to the bailee, in the case of a gratuitous

bailment, and if he does not disclose them he will be liable for the loss resulting therefrom; and in the case of a non-gratuitous bailment the bailor is responsible for damage resulting from defects interfering with the material use and enjoyment of them, even though such defects are not known to the bailor (Sec. 150).

2. *To repay expenses to the bailee* :—The general rule is that, in the absence of a contract to the contrary, in the case of a gratuitous bailment, all ordinary expenses should be borne by the bailee, while the extraordinary expenses should be borne by the bailor. In the case of a non-gratuitous bailment, even the ordinary expenses incurred by the bailee for the purpose of bailment should be borne by the bailor (Sec. 158).

3. *Responsible to the bailee for loss arising from defective title* :—Sections 164, 166 and 167 lay down the following rules :

- (1) Loss arising from defective title to the bailee, should be borne by the bailor (Sec. 164).
- (2) If the bailee re-delivers the goods bailed in good faith according to the directions of the bailor, the bailee is not in any way responsible to the real owner of those goods (Sec. 106).
- (3) The real owner can however obtain an order from the Court preventing the bailee from delivering the goods to the bailor (Sec. 167).

### Bailee's Lien

“Lien signifies the right of a person, who has possession of the goods of another, to retain such possession until a debt due to him has been discharged. This right is sometimes called a ‘*Possessory lien*’.”

Possessory liens are of two kinds : (i) *Particular* and (ii) *General*.

(i) A *particular lien*, also called ‘special lien’, is a right to detain the goods belonging to another, for the discharge of a debt or liability which had arisen in respect of those goods; for example for work done on them, or charges incurred for their safe custody.

(ii) A *general lien* is a right to detain goods belonging to another, not only for the discharge of debt or liability incurred in connection with them, but also for a general balance of account between their owner and the person detaining the goods.

The persons entitled to a particular lien are:—(i) bailees *e.g.*, carriers, mechanics, repairers, inn-keepers ; (ii) unpaid sellers of



goods ; and (iii) agents in respect of all their claims against their principals. Persons entitled to a general lien are bankers, factors, wharfingers, attorneys of High Court and policy brokers.

Sections 170 and 171 enact as follows :—

“ Where the bailee has in accordance with the purpose of the bailment rendered any service involving the exercise of labour or skill in respect of the goods bailed, he has, in the absence of a contract to the contrary, a right to retain such goods, until he receives due remuneration for the services he has rendered in respect of them ” (Sec. 170).

“ Bankers, factors, wharfingers, attorneys of a High Court and policy brokers may, in the absence of a contract to the contrary, retain, as a security for a general balance of account, any goods bailed to them, but no other persons have a right to retain as a security for such a balance, goods bailed to them, unless there is an express contract to that effect.” (Sec. 171).

It is therefore clear from the above sections that bailees other than those enumerated in Section 171, cannot claim a general lien, but that they can acquire it by means of an express contract to that effect.

*Rights of Bailor and Bailee against third persons* :—The English Law is contained in the decision *In re Winkfield* (1902) P. 42, and the Indian Law is laid down in Secs. 180 and 181 :—

“ If a third person wrongfully deprives the bailee of the use or possession of the goods bailed, or does them any injury, the bailee is entitled to use such remedies as the owner might have used in the like case—if no bailment had been made, and either the bailor or the bailee may bring a suit against the third person for such deprivation or injury.” (Sec. 180).

(2) “ Whatever is obtained by way of relief or compensation in any such suit shall, as between the bailor and bailee, be dealt with according to their respective interests.” (Sec. 181).

*Finder of Lost Goods* :—We have already seen that a finder of lost goods is under obligations similar to those of a bailee, on the basis of a quasi-contract. (Sec. 71 *supra*). Secs. 168 and 169, lay down the following rules relating to his rights :

- (1) Finder of lost goods cannot recover remuneration for trouble and expense voluntarily incurred by him for preserving the goods and finding out the owner.
- (2) He may however exercise particular lien against the goods, for such remuneration.
- (3) Where however, a reward has been offered for the return of the goods he can sue for such reward.
- (4) Where the goods found are the subject of a sale, and the owner cannot be found after reasonable search, or refuses, to pay the lawful

charges of the finder, he may sell them when: (a) they are about to perish or lose the greater part of their value, or (b) the lawful charges of the finder amount to  $\frac{2}{3}$  of their value.

*Pawn or Pledge*:—Pawn is a bailment of goods as security for the payment of a debt or performance of a promise. In this case the bailor is called the *pawnor*, and the bailee is called the *pawnee*. (Sec. 172.)

The goods which are pawned continue to be the property of the pawnor, but their possession will be with the pawnee. That distinguishes a pawn from a mortgage. In the case of a *mortgage of goods* the property in the goods passes to the mortgagee, though their possession remains with the mortgagor. A pawn should again be distinguished from a *lien*. In the case of a pawn the pawnor can sell the goods subject to certain conditions, but in the case of a lien there is no power to sell, and the only right is to detain the goods.

*Rights of Pawnee*.—The law is laid down in Sections 173 to 176 as follows :—

- (1) The pawnee can retain the goods not only for the payment of the debt, but also for interest, and expenses incidental to possession or preservation of goods. (Sec. 173).
- (2) In the absence of a contract to the contrary, the pawnee cannot retain the goods for debts other than that for which the pawn was made, but such a contract shall be presumed in the case of advances made subsequent to the pawn (Sec. 174).
- (3) The Pawnee is entitled to receive all extraordinary expenses incurred by him for the preservation of goods pledged (Sec. 175).
- (4) Where the pawnor makes default in payment of debt, the pawnee may :
  - (i) bring a suit upon the debt, retaining the goods pledged as collateral security; or
  - (ii) himself sell the thing pledged after giving the pawnor reasonable notice. If the proceeds of such private sale are less than the debt, the pawnor is liable for the balance. If they are in excess, pawnee shall pay the surplus to the pawnor. (Sec. 176).

*Right of Redemption of the pawnor*:—The pawnor's ownership in the goods bailed is specially protected, and so even though the time stipulated for the payment of the debt, or performance of the promise, for which the pledge is made, has expired, and the pawnor has committed default, he is nevertheless, permitted to redeem the goods pledged at any subsequent time before

they are actually sold. But the pawnor must, before redemption, pay any expenses which have arisen from his default (Sec. 177).

*Pledge of goods by non-owners:*—It is only the owner of goods that can make a valid pledge of them, and the general rule is expressed by the maxim "*Nemo dat quod non habet*" (no one can convey a better title than what he has). The rule applies to contracts of sale, as well as to contracts of pledges. If the rule were otherwise, there will be no safety for the owners of goods, and there will be any amount of temptation for pawn-brokers to join hands with thieves and swindlers. But even to this rule there are some exceptions. The law was formerly contained in Sec. 178 of the Contract Act, which gave rise to a conflict of judicial opinion regarding the meaning of the word 'possession' in that section. But at the time of passing the Bill relating to Sale of Goods, the Indian Legislature resolved the conflict by recasting Sec. 178 into two Sections *viz.* 178 and 178-A. According to them, a pledge of goods made by a person, who is not the real owner, is valid and binding on the owner in the following cases :—

(1) Pledge by a mercantile agent ; A mercantile agent is an agent having in the customary course of business, as such agent, authority either to sell goods or to buy goods, or to raise money on the security of goods, (Sec. 2 (9) Sale of Goods Act). A pledge by a mercantile agent, which is not authorised by the owner of the goods will be valid, if the following conditions are satisfied :

- (a) The mercantile agent is in possession of goods, or document of title to the goods, *viz.*, bill of lading, ware-house keeper's certificate, whar-finger's certificate, railway receipt, etc., (Sec. 2 (4) Sale of Goods Act.)
- (b) Such possession is with the consent of the owner.
- (c) He is acting in the ordinary course of business, while making the pledge.
- (d) The pawnee acts in good faith, and
- (e) The pawnee had no notice of the pawnor's defective title (Sec. 178).

In a case decided according to the old Sec. 178 of the Contract Act, the Privy Council, affirming the judgment of the Madras High Court, held that a railway receipt was a document of title, and that a pledge of the same has the same effect as pledging the goods represented by it. *Official Assignee of Madras v. Mercantile Bank of India, Ltd.* 58 Mad. 181 (P.C.). It may be

noted that Sec. 178, before amendment, did not expressly include a railway receipt in the list of documents of title to the goods, but S. 2 (b) of the Indian Sale of Goods Act now expressly includes it in the definition of documents of title.

(2) A person obtaining possession of goods under a contract voidable under Sec. 19 or 19-A of the Contract Act (*i.e.*, voidable on the ground of coercion, fraud, undue influence or misrepresentation) may make a valid pledge of them, to the following conditions are satisfied :

- (a) The contract under which the pawnor obtained possession of the goods has not been rescinded at the time of the pledge;
- (b) The pawnee acts in good faith ; and
- (c) The pawnee has no notice of the pawnor's defective title (Section 178-A).

Cases in which a person, who is not the owner of goods, can validly sell them, are considered under Secs. 27 to 30, Sale of Goods Act (*in fra*).

The last point to be noted is that a person having only a limited interest in the goods, can make a valid pledge to that extent (Sec. 179).

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## CHAPTER XVII

### AGENCY

In this busy world it is not always possible for a man to do everything by himself, and he has necessarily to delegate some of his acts to be performed by another, and that person is called an 'agent', and the contract by which he is appointed is called 'agency'. This contract is most frequently resorted to by traders, who carry on business in manifold directions, and in countries known and unknown to them. The law of agency is based on the maxim "*Qui facit per alium facit per se*" i.e., what a person does by another he does himself. The law of agency is dealt with in Chapter X (Secs. 182 to 238) of the Indian Contract Act. *Definition* : In English Law, a contract of agency is defined as the employment of one person by another, in order to bring the latter into legal relations with a third person.

Section 182 defines thus :

"An 'agent' is a person employed to do any act for another or to represent another in dealing with third persons. The person for whom such act is done, or who is so represented is called the 'principal'."

Thus it is clear from both the definitions, that the idea underlying agency is the idea of representation of one person by another, making an agent a conduit pipe or a connecting link between his principal and third persons. The position of an agent is in law superior to that of a servant, but inferior to that of an independent contractor. That is why an agent is sometimes called a superior servant.

*Contract of Agency* :—A contract of agency possesses all the features of a contract, with some peculiar features of its own. Since the chief object of employing an agent is to bring the principal into legal relations with third persons, it follows that the principal himself must be a person capable of entering into a contract. Sec. 183, lays down that:—

"Any person who is of the age of majority according to law to which he is subject and who is of sound mind may employ an agent." (Section 183).

and Section 184 provides that:—

“As between the principal and third persons any person may become an agent ; but no person who is not of the age of majority and of sound mind can become an agent so as to become responsible to his principal according to the provisions in that behalf herein contained.”

Thus according to Section 184 an agent may not be a major, or a person possessing a sound mind, but yet he can effectively bind the principal and the third persons, by bringing them into contractual relations. He cannot however be held liable either by the principal or by third parties.

Consideration, as we have seen, is essential for the validity of every contract, and we have also noticed that consideration in the sense of detriment, is sufficient to support a contract. When A employs B as his agent, inasmuch as A's affairs are placed in B's hands, A suffers a detriment, and therefore no further consideration in the shape of remuneration need be present. In other words, a gratuitous contract of agency is perfectly valid, and an agent under it will be as much bound by his contract as a paid agent. This principle, though not in happy language, is expressed in Sec. 185, as follows:—

“No consideration is necessary to create an agency.”

Kinds of Agency :—A contract of agency may be formed in any one of the following ways :—

1. Agency by precedent authority.
2. Agency by subsequent authority, or ratification.
3. Agency by estoppel.
4. Agency by holding out.
5. Agency of necessity.

1. *Agency by precedent authority* :—This is the most ordinary mode of creating agency viz., by appointing an agent either by words spoken, or written (as in the case of a vakalat, or a power of attorney).

2. *Agency by subsequent authority* :—In this case the person who purports to act as an agent has either no authority at all, or in regard to a particular act or contract he exceeds his authority. But the principal, on whose behalf he acts, can subsequently validate the act or contract, by signifying his approval. The act or contract would then be as valid as if it were done in pursuance of

prior authority, and this kind of agency is called "*expost facto agency*" or *ratification*. It will be considered in detail later on.

3. *Agency by estoppel* :—In many cases, an agency may be implied from the conduct of the parties, though no express authority has been given. For instance if A proclaims himself as the agent of B, and B knowing the same does not contradict it, and a third person C enters into a contract with A, on the basis that A is B's Agent, B will be estopped from denying subsequently that A is his agent. This is a case of agency by estoppel.

4. *Agency by holding out* :—The most familiar instances of this kind of agency are to be found in the case of a servant and a wife. If a master permits his servant, by a long course of conduct, to pledge his credit for certain purposes, he is bound by the acts of his servant in pledging his credit for similar purposes, though in some instances without the permission of the master. Because the master held out the servant as an agent, the law implies an agency, and the trader will be entitled to proceed on that basis.

5. *Agency of necessity* :—Some times the exigencies of circumstances require that a person, who is not really an agent, should act as an agent of another, *e.g.*, where a person entrusts his property to another, and it becomes necessary to incur some obligation for the purpose of preserving it. In such a case though there might not have been an express authority to incur that obligation, the law implies such an authority in favour of that person, on account of the necessity that had arisen. Before an agency of necessity can be inferred the following conditions have to be satisfied :

(i) There should be an actual and definite necessity for the creation of the agency. *Prager v. Blatspiel Stamp & Heacock Ltd.*, (1924) 1 K. B. 566.

(ii) It should be impossible to obtain the principal's instructions.

(iii) The person acting as agent must have acted bonafide, in the interests of all parties concerned.

*Husband and wife* :—The legal relationship between husband and wife is interesting and peculiar, and the question of extent of wife's authority to pledge her husband's credit comes up for decision before Courts very often. The following principles have to be applied in this connection :

(i) If a man and a woman are living together, and the wife is charged with the duty of looking after the household, a presumption is raised that she has got authority to pledge her husband's credit for necessities. *Debenham v. Mellon* (1880) 6 Appeal Cases 24. But this presumption may be rebutted, as in the following cases, when the wife cannot pledge her husband's credit :

- (1) where the wife is forbidden from purchasing anything on credit, or from contracting debts ;
- (2) where the goods purchased on credit are not necessities *e.g.*, a radio set for a clerk drawing Rs. 30 per month ;
- (3) where the wife is given sufficient money for purchasing necessities, and forbidden from pledging his credit. *Morel Bros v. Westmoreland* (1904) A. C. 11 ;
- (4) where the trader has been expressly warned not to give credit to his wife.

(ii) When the wife lives apart from the husband under justifiable circumstances, the husband would in law be liable to maintain her, and he would therefore be bound to pay her bills for maintenance during that period. According to some jurists, this authority of the wife is an instance of agency of necessity.

*Classification of Agents* :—One broad classification of agents is into : (i) mercantile or commercial agents, and (ii) non-mercantile or non-commercial agents. We are mainly concerned with mercantile agents.

Another classification of agents is : (i) General and (ii) special. A *general agent* has authority to do all acts of some general class *e.g.*, managing directors of a company etc. A *special agent* on the other hand, is one with limited authority to do some particular act, or enter into some particular contract. In either case a principal will not be liable for acts done in excess of his authority, unless they are subsequently ratified by the principal.

The following are some of the important mercantile agents :

1. *Auctioneer* :—He is an agent approved by the seller to sell goods by public auction, for a remuneration in the shape of a commission. He has authority to deliver goods only on payment of the price, and he is entrusted with the possession of goods. An auctioneer is also the agent of the buyer under English Law, for



the purpose of signing the memorandum, under the English Sale of Goods Act.

2. *Banker* :—The relationship between a banker and his customer is that of a debtor and a creditor, with the superadded liability on the part of the banker to honour the drafts (cheques) of the customer. To this extent, it is said that a banker is an agent of his customer.

3. *Broker* :—A *broker* is a mercantile agent employed for making bargains and contracts in all matters of trade, for a commission called brokerage. A broker, unlike a factor, is not entrusted with the possession of goods. The usual method of dealing by a broker is to make entries of the terms of a contract in a book and to sign them, and to send particulars of the same to both parties. The document sent to the seller is called the *sold note*, and the one sent to the buyer is called the *bought note*, and where both of them agree, the terms of the contract are defined. The broker is an agent of the seller, as well as the buyer.

4. *Factor* :—A *factor* is a mercantile agent entrusted with the possession of goods, and who has authority to buy, or sell, or otherwise deal with goods or merchandise, or to raise money on their security. He has a general lien on the goods, as already noticed.

5. *Commission Agent* :—A *commission Agent* is an agent employed to buy, or sell goods, or transact business for a remuneration called the commission.

6. *Delcredere Agent* :—A *delcredere Agent* is an agent who in consideration of an extra remuneration called the delcredere commission, guarantees to his principal that third persons, with whom he enters into contract, shall perform the obligations. This arrangement by which an agent guarantees the fulfilment of promises by third persons, or their solvency, is generally resorted to when the agent deals with persons residing in foreign countries, about whom his principal knows nothing. A delcredere agent thus occupies the position of a guarantor as well as of an agent.

*Scope of Agent's Authority* :—As already stated, an agent is a superior servant, and so he is not expected to take instructions from his principal with regard to every trivial detail. He has authority to do all things necessary for carrying out the particular purpose for which the contract of agency is created. When a

person is held out as an agent for a particular purpose or business, persons dealing with him are entitled to presume that he has authority to do all such acts as are necessary or incidental to such a business. Such authority is called *ostensible authority* of an agent, as distinguished from *actual or real authority*. It is ostensible authority that determines the *scope of an agent's authority*. The ostensible authority of an agent may be curtailed by his principal. If a particular contract, though in excess of the actual authority, is still within the ostensible authority, the contract will be binding upon the principal, unless the third party enforcing that contract is aware of the limitation imposed on the agent's ostensible authority. The Indian Law is laid down in Secs. 188 and 237, as follows :—

“An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. An agent having an authority to carry on business has authority to do every lawful thing necessary for the purpose, or usually done in the course of conducting such business” (Sec. 188).

“When an agent has, without authority, done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations, if he has by words or conduct induced such third persons to believe that such acts and obligations were within the scope of “agent's authority.” (Sec. 237).

Though the scope of authority of an agent under normal circumstances is defined in Sec. 188, still in cases of an emergency he should have larger powers; and Sec. 189, therefore lays down as follows :—

“An agent has authority, in an emergency, to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case under similar circumstances.”

In such cases the authority is deemed to be conferred by, what has been described above as, agency of necessity.

*Can an agent appoint a sub-agent:*—The ordinary rule is that an agent, being a person enjoying the confidence of his principal, cannot delegate his duties to another, and this is expressed by the maxim '*delegatus non potest delegare*' i.e., a delegate cannot further delegate. *De Busche v. Alt* (1878) 8 Ch. D. 286. An agent cannot therefore appoint a sub-agent without the permission of the principal. To this rule the following are the exceptions :—

- (i) where the duties of the agent do not require any skill or confidence, and can be satisfactorily performed by any one ;

- (ii) where the custom prevailing in the trade, or trade usage as it is called, permits delegation ;
- (iii) where the principal knows that the agent intends to delegate;
- (iv) where the nature of the business requires delegation;
- (v) in unforeseen emergencies (Sec. 190).

*Difference between Sub-Agent and Substituted-Agent:—*Sec. 191 defines 'a sub-agent' as :

"a person employed by, and acting under the control of, the original agent in the business of the agency."

A substituted-agent is defined by Sec. 194, thus:—

"where an agent holding an express or implied authority to name another person to act for the principal in the business of the agency, has named another person accordingly, such person is not a sub-agent but an agent of the principal for such part of the business of the agency as is entrusted to him."

Thus the difference between the two is that an agent not only appoints a sub-agent but also keeps him under control, and the agent himself will be responsible for the acts of the sub-agent. But in the other case the duty of the agent ends with appointing or naming a particular person for being appointed as a "substituted agent." The moment the substituted agent is appointed, privity of contract will be established between him and the principal, and the original agent disappears out of the scene altogether. The care that ought to be exercised by an agent in selecting a substituted agent is that which a man of ordinary prudence would exercise in his own case (Sec. 195).

*Sub-agent properly appointed, and sub-agent improperly appointed :—*We, have seen above that an agent has authority to appoint a sub-agent either with the express permission of the principal, or in five cases without such permission. In cases where an agent, having authority to do so, appoints a sub-agent, he is called a sub-agent properly appointed; while in cases where an agent, without authority appoints a sub-agent, he is called a sub-agent improperly appointed. In either case since a sub-agent is appointed by, and acts under the control of the agent, there is no privity of contract between the sub-agent and the principal, *i.e.*, the sub-agent cannot sue the principal for the remuneration, and the principal cannot sue the sub-agent for any moneys due from him. Each of them can proceed only against his immediate contracting party, *viz.*, the agent. A sub-agent properly appointed can however represent the principal by entering into contracts with third

persons, which will be as binding on the principal, as if they were entered into by the agent. But a sub-agent improperly appointed cannot represent the principal as regards third persons, but can only bind the agent by contracts entered into with them. The agent may therefore be held liable for contracts entered into by a sub-agent improperly appointed, by the third parties on the one hand, and the principal on the other. (Secs. 192 and 193).

*Expost-facto agency or ratification* :--The meaning of this term has been explained already, and the law on this subject is expressed by saying that ratification relates back to and is equivalent to prior authority. It may be express or implied from conduct, *Bhawanishanker v. Gordhandas* I. L. R. 1944 Mad. 1 (P.C.). Thus if A, without having any authority of B, acts as B's agent and enters into a contract with C for the purchase of cloth the contract will be binding on B if he ratifies or approves the same. The agency in this case is called *expost facto*, because it is created subsequent to the contract. The same rule is expressed in Sec. 196 thus :

"where acts are done by one person on behalf of another, but without his knowledge or authority, he may elect to ratify or disown such acts. If he ratify them, the same effects will follow as if they had been performed by his authority".

This rule relating to ratification is subject to several limitations, and they are stated below :

*Essentials of ratification* :—1. It must be by a person who had the capacity to authorise the transaction, when it was entered into as well as on the date of ratification. Thus a minor, on whose behalf a contract was entered into, cannot ratify the same after attaining majority.

2. The person who entered into the contract must have expressly contracted as an agent, *Keighley v. Durant* (1901) A.C. 240. In other words the act ratified must have been done by the agent not for himself, but intending to bind a named or ascertainable principal. *Imperial Bank of Canada v. Mary Victoria Begley* A. I. R. 1936 P. C. 193 (Canada).

3. The person ratifying must have been in existence on the date of the transaction. Thus contracts entered into by promoters of a company on its behalf, cannot be ratified by the company after it comes into existence. *Kelner v. Baxter*, (1886) 2 C. P. 174.

4. It must be made by a person possessing full information of all material facts, and with the intention of making himself liable as a principal (Sec. 198).

5. It cannot be made with regard to void or criminal acts, but can be made with regard to lawful or even voidable acts.

6. It must be only of such acts as the person ratifying has power to do, e.g., acts of directors which are *ultra vires* the powers of a company cannot, even by ratification of all the shareholders, be made binding on the company.

7. It must be of the whole transaction, and not part of it (Sec. 199).

8. It should not be made so as to subject a third person to damages, or terminate any right or interest of a third person (Sec. 200). Thus a tender of performance made by an unauthorised agent, cannot be ratified by the principal, so as to defeat the rights of the person who refused such performance.

9. It should be within a reasonable time after the contract was entered into by the agent.

*Agency—How terminated:*—The Indian Law is contained in Sec. 201, but it is incomplete. But it is settled law that the authority of an agent comes to an end in the following cases:—

1. Where the agency is for a fixed period, on the expiration of that period.
2. By the principal revoking the authority.
3. By the agent renouncing his authority.
4. By the business of the agency being completed.
5. By the principal or agent dying, or becoming of unsound mind.
6. By the principal being adjudicated an insolvent.
7. By the business of the agency becoming impossible of being carried out, either on account of destruction of subject-matter, or by its being rendered unlawful.

*Note:*—Where an agency is terminated on account of death or lunacy of the principal, the agent should take all reasonable steps for the preservation of property, on behalf of the legal representatives of the principal (Sec. 209). Further if an agency is for a particular period, and the principal or the agent renounces

or revokes the authority before the expiry of that period, the party so doing, without sufficient cause, will have to compensate the other for the resulting loss (Sec. 205). In the case of renunciation as well as revocation, reasonable notice of the same should be given to the other side. Otherwise the party not giving such notice will be liable in damages to the other party (Sec. 206). Sections 205 and 206 also apply to sub-agents.

*When agency cannot be terminated:*—Agency cannot be terminated by the principal in the following cases :

1. When the agency is one coupled with interest (Sec. 202).
2. Where the authority has been partly exercised, it cannot be revoked with regard to acts and obligations arising from acts already done in the agency (Sec. 204).

*Agency coupled with interest:*—Agency is said to be coupled with interest when authority is given for the purpose of securing some benefit to the agent. Examples of agency coupled with interest are :

1. Where the principal authorises the agent to sell goods at the most profitable prices, and realise the debt due to him from the principal.
2. Where the agent is authorised to collect rents from the estate of the principal, with which he has to discharge debts due to him from the principal.
3. Where A sells the goodwill and book debts of his business to B, and appoints B as his (A's) agent to collect the debts.

In these three cases it can be seen that the business of agency is the security upon which the agent hopes to collect the amount due from the principal. But the mere prospect of earning remuneration which will always be present, will not make the agency one coupled with interest. In the case of an agency coupled with interest the agency cannot, in the absence of an express contract, be terminated to the prejudice of such interest.

*When termination of agency takes effect:*—The law is laid down in Secs. 208 and 210, as follows :—

1. The authority of an agent, so far as he is concerned, comes to an end the moment he knows that the authority has terminated (Section 208).
2. So far as third parties are concerned, they can proceed to deal with the agent, as such, till they come to know of the termination of the authority. (Section 208.)

Thus where an agent knows that his authority has terminated, but yet enters into a contract with third parties, who are not aware of such termination, the contract will be binding upon the principal or his legal representatives as the case may be. *Ebrahim v. Chumilal* 35 Bom. 332. Of course in such cases the agent will be liable in damages to the principal, or his legal representatives, as the case may be. According to English Law, agency is determined with respect to the agent, as well as third parties, by death or insanity of the principal, though that fact is not known to them. But in India, it is determined only when the fact of death or insanity comes to their knowledge. After the termination of the agency by death or insanity of the principal, the agent is bound to take reasonable care of the principal's properties in his hands (Sec. 209).

3. On the termination of the authority of an agent, the authority of all sub-agents is also terminated (Sec. 210).

*Duties of an agent* :—1. An agent should not only act within the scope of his authority, but should also carry out the express instructions of the principal. Where he does not follow them, but follows a different course, though *bona fide*, and in the best interests of the principal, the agent will have to indemnify the principal for the loss caused thereby, *Lilley v. Doubleday*, (1881) 7 Q. B. D. 510. (Sec. 211).

2. An agent should conduct the business, in the absence of directions, according to the local custom, and trade usage (Sec. 211).

3. In cases of difficulty, he should use reasonable diligence in communicating with the principal and in seeking to obtain his instructions (Sec. 214).

4. An agent should conduct the business with the skill that is generally possessed by persons engaged in similar business, except where the principal knows that the agent is wanting in skill. But he must always use the skill he possesses, and act with reasonable diligence (Sec. 212).

5. Where an agent fails to do so, he is bound to compensate the principal for all direct consequences of his own neglect, want of skill or misconduct (Sec. 212).

6. An agent is bound to render proper accounts to the principal on demand (Sec. 213).

Where an agent, contrary to the terms of the contract with his principal, failed to maintain proper accounts, and examine the books of his subordinates, he was held liable to compensate the principal not only for loss resulting from his acts and negligence, but also for the frauds and defalcations of his subordinates resulting therefrom. *James Eggay Taylor v. United Africa Ltd.*, A.I.R. 1937 P.C. 78 (from West Africa).

7. Except the lawful deductions that can be made by an agent towards his remuneration and expenses, he should deliver to the principal all monies including secret commissions received by him.

8. An agent should not set up the title of third parties, or of himself, to the property or goods in his hands as an agent, and he should not use information obtained by him as an agent against the principal.

9. An agent should not deal on his own account in the business of the agency, without obtaining the consent of the principal, and acquainting him with all material information known to him on the subject. If the agent fails to do so and carries on the said business on his account, or after giving the consent the principal finds that the dealings of the agent are prejudicial to his interests, the principal may repudiate the transactions entered into by the agent, and disclaim all losses (Sec. 215). If the agent without the knowledge of the principal deals in the business of the agency on his own account, and not on behalf of the principal, the principal can nevertheless claim the profits resulting from such transactions.

10. An agent should not disclose confidential information, supplied to him by the principal. But he is under no obligation to disclose to his principal that he committed a breach of his duty by taking secret profits. *Bell v. Lever Bros.* (Supra).

#### *Rights of an Agent.*

1. To claim remuneration :—The first and foremost right of an agent is, except when his appointment is gratuitous, to claim remuneration or commission, and expenses properly incurred by



him. The right to claim remuneration arises the moment the business of the agency is complete. The amount of remuneration payable to an agent depends on the terms of the contract between him and the principal. The agent will be entitled to remuneration even if the principal, by some wrongful act or default, prevents the transaction from being completed, with a view to defeat the agent's claim.

Where however the principal withdraws his instructions before a binding contract is made by the agent with the third party, the agent will not be entitled to the commission. *Luxor Ltd. v. Cooper.* (1941) A. C. 108.

Even after a person is appointed as an agent to sell property, the principal is, in the absence of a stipulation to the contrary, entitled to sell the property himself, or through another agent. But where a sole agent is appointed for the purpose of sale, the principal cannot appoint other agents, though he can sell it himself, without paying any commission to the sale agent. *Bentall, Horsley and Baldry v. Vicary.* (1931) 1 K. B. 253.

Where an agency is created for a fixed time, but is revoked before the expiry of that period, the agent will not be entitled to claim damages for being prevented from earning commission for the unexpired period, unless there is an obligation express or implied to continue the agency for that time. *French & Coy., Ltd. v. Leeston Shipping Coy., Ltd.* (1922) 1 A.C. 451. Whether there is such an obligation or not, depends on the circumstances of the case.

A broker, who is employed by a seller to introduce him to a prospective purchaser, is entitled to whatever is in the circumstances, the usual commission, on all contracts resulting from that introduction. But where a subsequent contract is the fruit not of the first introduction, but of the satisfactory business relationship, which the introduction established, it will carry no commission for the broker. *Valashak Seth Apear v. Standard Coal Co.* (1943) 2 M. L. J. 405 (P. C.)

Where the agent is guilty of misconduct, like earning secret commission, he will be compelled to refund that amount to the principal, and if he receives it fraudulently, he (agent) will also forfeit his commission in respect of the transaction in connection with which the corrupt bargain was made. *Andrews v. Ramsay & Co.* (1903) 2 K. B. 635. (Sec. 220).

2. An agent has got a particular lien, in respect of claims arising out of the business of agency, and he can exercise the same against moneys, goods, papers and other property, either movable or immovable belonging to the principal (Secs. 217 and 221).

3. An agent is entitled to be indemnified against all consequences arising out of lawful acts done by him within the scope of his authority (Sec. 222). *Christoforides v. Terry* (1924) A. C. 566.

4. An agent is entitled to be indemnified against the consequences of an act causing injury to the rights of third persons, but which was done by the agent in good faith, while exercising the authority (Sec. 223). But this right of indemnity does not apply to criminal acts of an agent, even though they are authorised by the principal (Sec. 224).

5. An agent can also claim compensation for injury caused to him (agent) by the principal's neglect or want of skill.

*Liability of principal to third persons.*

1. The idea underlying agency being representation of one person by another, the principal is vicariously bound by all contracts, and liable for all obligations arising from the acts of the agent, as if he has incurred them personally (Sec. 226).

2. The principal is liable, as regards third persons, for all acts and obligations of an agent falling within the scope of his ostensible authority, though they may be beyond his actual authority (*supra*). Where the agent exceeds the authority granted to him, the principal may ratify such acts. But where they are not ratified, and where a part of the act done by the agent, which is within the authority can be separated from that, which is beyond the authority, so much of the act as is within authority will be binding upon the principal (Sec. 227). Where such separation is not possible, the entire transaction will not be binding upon the principal (Sec. 228). For instance if an agent, authorised to draw a bill for Rs. 200 draws a bill for Rs. 1,000 the principal will not be liable even to the extent of Rs. 200.

3. The principal will be liable even for misrepresentations made, or frauds committed, by agents in the business of the agency for their own benefit. *Lloyd v. Grace Smith & Co.*, (1912) A C. 716. But if they are made in respect of matters not falling within the authority of the agent, the principal will not be liable (Sec. 238).

4. The principal is bound by any notice given to, or information obtained by the agent in the course of the business transacted by him (Sec. 229). *Bawden v. London etc., Assurance Co.* (1892) 2 Q. B. 534.

5. Where an agent enters into a contract on behalf of the principal, but without disclosing his name, the third parties can, on discovering his name, proceed against him for the contract entered into by the agent. The agent cannot be made personally liable

under such a contract. *Universal Steam Navigation Coy., Ltd. v. James Mc Elvie & Co.* (1923) A. C. 492.

6. Even in cases where an agent is personally liable, a person dealing with the agent can hold either him, or the principal, or both liable (Sec. 233). According to English Law the third party can proceed only against one of them, and not against both. It may however be noted that the third party cannot sue the principal, or the agent, as the case may be, where he induced either of them to believe that he would not be made liable, and the other alone would be made liable (Sec. 234).

*Rights of parties to a contract where an agent does not disclose agency.*—The law is contained in Sections 231 and 232, Indian Contract Act. If an agent makes a contract with a person who neither knows nor has reason to suspect that he is an agent his principal, may require the performance of the contract; but the other contracting party has, as against the principal, the same right as he would have had against the agent if the agent had been the principal. But this right will not be available to the principal, if he discloses himself before the contract is performed by the other party, and if the other party could show that, he would not have entered into the contract, had he known that the agent is not the principal (Sec. 231).

Where a person enters into contract with another, without knowing or having reason to believe that he is an agent, if his principal requires performance of the contract he can only obtain it subject to the rights and obligations between the agent and the party to the contract (Sec. 232). Thus if A, who has to recover Rs. 200 from B, enters into a contract with him for the purchase of yarn for Rs. 500 and B, entered into the contract as an agent of C, but did not disclose that fact to A, then C cannot compel A to take the yarn without allowing him (A) to set off the sum due to him from B, namely Rs. 200.

*Liability of agent to third parties.*

1. If a person untruly represents himself to be the authorised agent of another, and thereby induces a third person to deal with him as such agent, he is liable, if his acts are not ratified by the alleged principal, to make compensation to the other party for any loss or damage arising from such dealings (Sec. 235). This liability is called liability for *breach of warranty of authority* (supra).

It is clear that if A, without having any authority but purporting to act as the agent of B, enters into a contract with C, and B

does not ratify the same, B cannot be made liable, because A was never his agent. A himself cannot be made liable by C for the performance of the contract, because he (A) never purported to contract for his own sake; but then should C be without a remedy? The only misconduct of A is that he made a misrepresentation of his authority, and according to the law relating to misrepresentation, damages cannot be claimed except when the misrepresentation is fraudulent. But this section gives redress and makes the agent liable in damages, even if he is only guilty of innocent misrepresentation, on the ground that there has been breach of warranty of his authority *Collen v. Wright* (1857) 8 E. & B. 647. The agent will be liable even in cases where the misrepresentation is due to his authority being terminated without his knowledge, *e.g.*, by the death or lunacy of the principal. *Yonge v. Toynbee* (1910) 1 K.B. 215.

2. An agent cannot claim performance of a contract entered into by him, apparently on behalf of the principal, but really on his own account (Sec. 236). But according to English Law if the agent purports to act for an undisclosed principal, though really for his (agent's) benefit, he can claim performance of that contract; but he cannot claim it if he purported to act on behalf of a named principal. In India such performance cannot be claimed by the agent in any case.

3. Though ordinarily an agent is not personally liable in respect of contracts entered into by him as agent, still in the following cases he will be personally liable :—

- (i) where the contract expressly provides for the personal liability of the agent ;
- (ii) where an agent does not sign on the negotiable instrument as an agent (Sec. 28, Negotiable Instruments Act) ;
- (iii) where the agent acts for a foreign principal ;
- (iv) where the agent acts for an undisclosed principal ;
- (v) where the agent acts for a principal who cannot be sued on account of his being a minor, or a foreign sovereign, etc. ;
- (vi) where the agency is coupled with interest ;
- (vii) where according to trade usage, agents in certain kinds of business are personally liable.

The Indian Law on this point, in S. 230, Indian Contract Act though not exhaustive, is to the same effect.



## CHAPTER XVIII

### SALE OF GOODS

*History of the Law* :—Originally the law relating to sale of goods was contained in Chapter VII of the Indian Contract Act ; but the same had been repealed, and the law is now embodied in the Indian Sale of Goods Act, III of 1930, and the sections referred to hereafter relate to the said Act.

The Indian Act is practically a replica of the English Sale of Goods Act 1893, except for a few principles, specially incorporated to meet the requirements of commerce in this country. Some of the principal changes brought about by the Act are as follows.

- (1) It has brought into great prominence, the idea that the passing of ownership in goods is a question of intention of the parties, and it has laid down a number of rules for deciding that question, where the parties fail to express their intention clearly.
- (2) A clear distinction is made between a sale, and an agreement to sell.
- (3) The difference between a warranty, and a condition has been rightly emphasised.
- (4) The rules regarding stoppage in transit, and auction sale have been amplified.
- (5) The cases in which a non-owner can convey a valid title have been comprehensively grouped together.

*Definition of Goods* :—According to Sec. 1 (1) of the English Sale of Goods Act ' goods ' includes all chattels personal (tangible moveable property), other than things in action, and money.

Section 76 of the Indian Contract Act, which has been repealed, defined thus :

"goods means and includes every kind of moveable property."

Section 3, Clause 34 of the General Clause Act defines *moveable property* as "property of every description, except immovable

property" and *immovable property* has been defined in Sec. 3, Clause 25 of that Act as including "land, benefits to arise out of land and things attached to the earth, or permanently fastened to the earth."

Sec. 2 (7) of the Sale of Goods Act defines thus :

"Goods means every kind of moveable property, other than actionable claims and money ; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale."

'Actionable claim' is defined as :

"a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation, or pledge of movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognise as affording grounds of relief whether such debt or beneficial interest be existent, accruing, conditional or contingent." (Sec. 3, Transfer of Property Act).

According to the definition in the English Act (*supra*) stock and shares are not goods, but according to Indian Law, stock and shares are goods. Money, according to both, is not included in the definition of goods. It is interesting to note that water gas, and electricity are all included in the definition of goods.

*Contract of Sale* :—Section 4, defines a contract of sale of goods as :

"a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer, for a price. There may be a contract of sale between one part owner and another,"

It may therefore be noted that barter, or exchange of one kind of goods for another, is not included in the definition. Further there cannot be a sale, unless there are two distinct individuals, *viz.*, the seller and the buyer. The definition includes an agreement to sell, as well as sale, and in Sec. 4 (3), the difference between the two is thus pointed out :

"Where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale, but where the transfer of property in the goods is to take place at a future time or subject to some condition, thereafter to be fulfilled, the contract is called an agreement to sell."

The points of difference between a sale and an agreement to sell are noted below :

## AGREEMENT TO SELL

- (1) It is an executory contract.
- (2) It creates a right *in personam*.
- (3) In case of its breach by the buyer, the seller, is only entitled to damages and not the price, since ownership has not passed to the buyer.
- (4) Since ownership has not passed to the buyer, the seller can effectively convey title in the goods to another person, and the original buyer can only claim damages.
- (5) Even if the goods happen to be in the possession of the buyer, if they are destroyed by accident, the loss will be the seller's, because the ownership is still his.
- (6) If the buyer pays the price, and the seller thereafter becomes an insolvent, the buyer cannot claim the goods, but can only claim a rateable dividend for the money paid.
- (7) If the buyer becomes an insolvent without paying the price, since the ownership has not passed to him, the seller can refuse to deliver the goods to the Official Assignee, unless the price is paid by him.

## SALE

- (1) It is an executed contract.
- (2) It creates rights *in rem*.
- (3) Since ownership has passed, even if the goods remain in the possession of the seller, he can sue for the price.
- (4) Ownership having already passed to the buyer, the seller will be guilty of conversion if the goods are sold to another. Moreover, the original buyer can recover the identical goods with whomsoever they be.
- (5) In those circumstances the loss will be the buyer's, even if they be in possession of the seller, because the title has vested in the buyer.
- (6) In those circumstances the title having already passed to the buyer, he can recover the identical goods from the Official Assignee.
- (7) In similar circumstances, the ownership having passed, the seller will be bound to deliver the goods to the Official Assignee, except when the seller has a lien over the goods.

A sale is neither a bailment, nor a contract for work or labour, because in the two latter cases ownership is not transferred. A contract of sale is different from a contract for work and material, in that the former contemplates the delivery of goods but in the latter the substance of the contract is the exercise of skill or labour, and the delivery of goods is only subsidiary.

In *Lee v. Griffin* (1861) 30 L. J. K. B. 252 a contract to supply artificial teeth to fit the mouth of a patient, was held to be a contract for sale of goods.

In *Robinson v. Graves* (1935) 1 K. B. 579 a contract with an artist who agreed to paint a picture for an agreed sum, on the canvass and with the materials to be supplied by the other party, was held to be a contract for work and materials, and not sale of goods.

*Sale and Hire-purchase Agreement:*—A contract closely resembling a sale, but different from it, is an agreement of hire-purchase, which is very popular in modern times. A hire-purchase agreement is an agreement for hire, with an option to purchase. In this kind of contract the hirer will have to pay every month a particular sum of money, and if he pays in that way for a fixed number of months, the hirer will become the owner of the goods on the payment of the last instalment, or a token sum, by which he is said to exercise the option of purchasing the goods *Helby v. Mathews* (1895) A. C. 471. If the hirer fails to pay any particular instalment, the owner, can with perfect impunity, terminate the contract, and take away the goods, because the ownership continues to remain in the owner. For this very same reason, even if the hirer becomes an insolvent, the goods will not vest in the Official Assignee, but will have to be delivered to the owner. The distinction between a hire purchase agreement pure and simple, and a sale, where the price is agreed to be paid in a number of instalments, is very subtle, and whether a particular contract belongs to one type or the other will depend upon whether the hirer has merely an option to purchase, or whether he has bought or agreed to buy the goods.

In England an Act called the Hire Purchase Act was passed in 1938. It applies to hire purchase and credit sale agreements (*i.e.*, agreements by which the price is payable by five or more instalments) where the total sum payable does not exceed £ 100/-, or in the case of motor vehicle £ 50/-, or in the case of live stock £ 500/-. The Act provides for certain implied conditions and warranties similar to a contract of sale.

*Contract of Sale:*—A contract of sale, like any other contract, has to satisfy the various essentials in order to be valid. Thus Sec. 5 (1) of the Act lays down :

“A contract of sale is made by an offer to buy or sell goods, for a price and the acceptance of such offer. The contract may provide for the immediate delivery of the goods, or immediate payment of the price, or both, or for the delivery, or payment by instalments, or that the delivery or payment or both, shall be postponed.

It may be noted that there is no provision in the Indian Act corresponding to Section 4 of the English Sale of goods Act, which requires a contract of sale of goods of the value of £ 10 or upwards to be in writing. On the other hand, Section 5, (2) of the



Act makes it clear that the contract of sale may be in writing, or by word of mouth, or partly in writing, or partly by word of mouth, or may be implied from the conduct of the parties.

The subject-matter of a contract of sale must necessarily be 'goods' which has been already defined, and the goods may be "either *existing goods* owned or possessed by the seller, or future goods." (Section 6). For example, a contract of sale relating to goods to be produced in a particular mill, or wheat that may grow on a particular field, may form the subject-matter of the contract. In this connection the definition of the phrase 'specific goods' may be noted. Section 2 (14) defines thus ;

" Specific goods means goods identified and agreed upon at the time the contract of sale is made."

For instance if A, owning a number of cows, promises to sell one of them, the contract is for unspecified goods, but if the cow that is to be sold has been pointed out, or has been described sufficiently, without any doubt as to its identity, the contract is for specific goods.

If the goods perish or be destroyed at the time of entering into the contract, without the knowledge of the seller, or subsequently, before the risk passes to the buyer, without any fault on the part of the seller, the contract is void, and this rule is stated in Sections 7 and 8 of the Act.

" Where there is a contract for the sale of specific goods, the contract is void if the goods, without the knowledge of the seller, have at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract." (Sec. 7).

" Where there is an agreement to sell specific goods, and subsequently the goods without any fault on the part of the seller or buyer, perish or become so damaged, as no longer to answer their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided." (Sec. 8).

It must however be noted that these sections relate only to specific goods, and not unspecified or unascertained goods. In the case of unascertained goods, even if they are destroyed, the contract would not become void, unless the entire bulk, of which the unascertained goods formed a part, is destroyed. In the above illustration, unless all the cows owned by the seller are destroyed, the contract to sell any one of them would not become void.

The contract of sale must be for a price, which is defined in Sec. 2 (10) as " the money consideration for sale of goods,"

**Section 9 enacts :**

“(1) The price in a contract of sale may be fixed by the contract or may be left to be fixed in a manner thereby agreed, or may be determined by the course of dealings between the parties.

(2) Where the price is not determined in accordance with the foregoing provisions, the buyer shall pay the seller a reasonable price. What is reasonable price is a question of fact dependent on the circumstances of each particular case.”

It may be observed that according to English Law, an agreement that the goods sold shall be for a price to be subsequently agreed, will not be a concluded contract, but such a contract is valid according to Indian Law. Where the price is to be fixed by a third party, agreed upon by the seller and the buyer, Sec. 10 enacts thus :

“(1) Where there is an agreement to sell goods on the terms that the price is to be fixed by the valuation of a third party and such third party, cannot or does not make such valuation, the agreement is thereby avoided: Provided that, if the goods or any part thereof, have been delivered to, and appropriated by the buyer, he shall pay a reasonable price therefor.

(2) Where such a third party is prevented from making such valuation by the fault of the seller or buyer, the party not in fault may maintain a suit for damages against the party in fault.”

*Stipulations in a contract of sale* :—We have already seen that the stipulations or terms in a contract may be either *conditions* or *warranties*. They are defined in Section 12 of the Act as follows :

“(1) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

(2) A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.

(3) A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated.

(4) Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract.”

It may be noted that, even in a case where there is a breach of condition, the party aggrieved may simply claim the lesser remedy of damages, and not ask for repudiation of the contract.

**Section 13 (1) provides as follows :—**

“Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition, or elect to treat the breach of

the condition as a breach of warranty, and not as a ground for treating the contract as repudiated."

But there are certain cases where, even for the breach of a condition, the party aggrieved is not entitled to repudiate the contract. They are enumerated in Section 13 (2) as follows :

"Where (i) a contract of sale is not severable and the buyer has accepted the goods or part therefor, or

(ii) where the contract is for specific goods, the property in which has passed to the buyer,

the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty, and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect."

**Conditions and warranties :—**Section 12 makes it clear that express terms may be conditions or warranties, depending on the intention of the parties. As regards time for payment, we have already noticed that even though the term is clearly expressed, it is not to be deemed as a condition. Section 11 of the Act lays down :

"Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be of the essence of the contract of sale. Whether any other stipulation as to time is of the essence of the contract or not depends on the terms of the contract."

But stipulations as to time for performance *viz.*, delivery of goods, have been held to be conditions *Bowes v. Shand* (1877) 2 A.C. 455.

*Implied conditions and warranties in a contract of sale :—*One noteworthy feature of the Act is that it enumerates the various conditions and warranties which are implied in every contract of sale, in the absence of a contract to the contrary. Thus stipulations relating to title, merchantability, identity, etc., are considered to be so important that they are treated as implied conditions.

The conditions which are implied in every contract of sale in the absence of a contrary agreement are as follows :—

(1) Condition that the seller has title to the goods. Section 14 (a) lays down that there is,

"an implied condition on the part of the seller that, in the case of a sale, he has a right to sell the goods and that, in the case of an agreement to sell, he will have a right to sell the goods at the time when the property is to pass."

The seller therefore gives an undertaking that title subsists not only at the time of entering into the contract, but will also subsist at the time of passing of the property.

(2) Condition that the goods shall correspond with the description. Section 15 lays down as follows :

“Where there is a contract for the sale of goods by description, there is an implied condition that the goods shall correspond with the description, and if the sale is by sample as well as by description, it is not sufficient that the bulk of the goods corresponds with the sample if the goods do not also correspond with the description.”

Goods are sold by description when the contract describes them, and the buyer contracts relying on that description. Specific goods may be sold by description when they are sold not simply as specific goods, but as goods answering a particular description *e.g.*, a motor cycle, hot water bottle, etc.

In *Vorley v. Whipp* (1900) 1 Q.B. 513 the seller agreed to sell a second hand reaping machine which the buyer had not seen, and which the seller stated was new the previous year, and used to cut only 50 acres. The buyer found, when it was delivered, that it was old and had been mended. Held it was a sale of goods by description and the article not having satisfied the description the buyer was entitled to reject it.

In the leading case of *Wallis v. Pratt* (1911) A. C. 394 the agreement was for the sale of English sainfoin seeds, exhibited by a sample. The sellers gave no warranty, express or implied, as to growth, description or any other matter. The sample, as well as the bulk actually supplied, turned out to be giant sainfoin, but not English sainfoin. It was held that the description of the goods not having been satisfied, there was a breach of condition and that the buyer could recover damages.

Even where the goods supplied are merchantable, if they do not correspond with the description, the buyer cannot be compelled to accept them. *Arcos Ltd. v. Ronaasen* (1933) A.C. 470.

(3) Condition that the goods shall be fit for a particular purpose.

To the general rule that a seller gives no undertaking as to the quality or fitness of goods for a particular purpose, Section 16 (1) and (3) lay down the following exceptions :

(i) Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which, it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not), there is an implied condition

that the goods shall be reasonably fit for such purpose. Provided that in the case of a contract for the sale of a specified article under its patent or other trade name, there is no implied condition as to its fitness for any particular purpose" (Sec. 16 (1)).

*Note*:—The rule laid down by the section is in accordance with the decision in *Frost v. Aylesbury Dairy Coy.* (1905) 1 K.B. 608, and the rule embodied in the proviso with the decision in *Baldry v. Marshall* (1925) 1 K. B. 260. Even where the seller is to manufacture goods according to the plan and specification of the buyer, he may still depend on the skill and judgment of the seller, in which case, this implied condition as to fitness would apply. *Cammell Laird Ltd. v. Manganese Bronze Ltd.* (1934) A.C. 402.

(ii) An implied warranty or condition as to quality or fitness for a particular purpose, may be annexed by the usage of trade, (Sec. 16 (3) ).

In *Bombay Burma Trading Corporation Ltd. v. Aga Muhammad* 34 Mad. 453, timber was purchased for the express purpose of using it as railway sleepers, and when it was found to be unfit for the purpose, the court held that the contract could be avoided.

(4) *Condition as to merchantable quality*:—There is always an implied condition that the goods purchased, though answering the description, should also be of a merchantable quality *i.e.*, a quality that is ordinarily accepted in the market. Section 16 (2) of the Act provides thus :

"Where the goods are bought by description from a seller who deals in goods of that description (whether he is the manufacturer producer or not) there is an implied condition that the goods shall be of merchantable quality; Provided that, if the buyer had examined the goods, there shall be no implied condition as regards defects which such examination ought to have revealed."

In *Jackson v. Rotax Motor Cycle Coy., Ltd.* (1910) 2 K.B. 937 it was held that where a substantial portion of motor horns delivered to the buyer were badly dented owing to bad packing, while the rest were badly polished owing to careless workmanship, and consequently were not saleable, the goods supplied were not of a merchantable quality, and that the buyer was entitled to reject the whole consignment.

In *Grant v. Australian Knitting Mills* 70 M.L.J. 513 (P.C.) an appeal from Australia the plaintiff (buyer) purchased underpants from a company dealing in those goods, and after wearing them contracted a skin disease on account of some defect in their manufacture. It was held that the underpants were not 'merchantable' within the meaning of the exceptions (i) and (ii) to Sec. 14 of Australian Sale of Goods Act, corresponding to Sec. 16 (2) of the Indian Act, as they could not be worn next to the skin, and that the company, which sold them was liable in damages.

(5) *Condition as to fitness of provisions for consumption* :—Sec. 111 of the Contract Act (which has been repealed) laid down

that "on the sale of provisions there is an implied warranty that they are sound." The Sale of Goods Act no doubt makes no express reference to this condition, but the condition as to merchantability must be deemed to include fitness for consumption in the case of provisions.

(6) *Condition that bulk shall correspond with sample* :—Whenever goods are sold by sample, it is but reasonable to expect that the buyer should have an opportunity to examine them and that they should correspond with the sample. Section 17 of the Act lays down as follows :

(i) A contract of sale is a contract for sale by sample where there is a term in the contract, express or implied, to that effect.

(ii) In the case of a contract for sale by sample there is an implied condition (a) that the bulk shall correspond with the sample in quality, (b) that the buyer shall have a reasonable opportunity of comparing the bulk with the sample, (c) that the goods shall be free from any defect rendering them unmerchantable, which would not be apparent on reasonable examination of the sample.

*Implied warranties* :—The Act has enumerated certain implied warranties, which will be given effect to, unless there is a contrary intention. They are :

(1) *Warranty as to quiet possession* :—Section 14 (b) of the Act lays down that there is in every contract of sale, an implied warranty that the buyer shall have, and enjoy quiet possession of the goods.

(2) *Warranty against charges and encumbrances* :—Section 14 (c) lays down that there is "an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made." It should, however, be noted that the above warranties and conditions will be implied even in cases where some of them have been expressed, provided that the conditions or warranties which are expressed are not inconsistent with the implied warranties and conditions (Sec. 16 (4)).

*Transfer of ownership* :—The most vexed question, and yet the most important one, which has to be studied is that relating to the transfer of ownership in goods. It has been noticed already that the difference between a sale, and an agreement to sell is that ownership is transferred in the former, while it is not transferred in the latter, and that whether or not

ownership has passed, has to be gathered from the intention of the parties. In a comparatively illiterate country like India, where the average layman or businessman has not developed the quality of reducing every contract of sale into writing with precise terms, the difficulty of Courts in giving effect to the intentions of the contracting parties is very considerable. To facilitate this difficult task, the Legislature has laid down certain rules in Secs. 20 to 24, for construing the intentions of parties, where they have not been expressed. But those rules apply only where there is no intention to the contrary. Sec. 19 of the Sale of Goods Act, enacts thus :

"Where there is a contract for the sale of specific or ascertained goods the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred.

(2) For the purpose of ascertaining the intention of the parties regard shall be had to the terms of the contract, the conduct of the parties and the circumstances of the case.

(3) Unless a different intention appears the rules contained in Sections 20 to 24 are rules for ascertaining the intention of the parties as to the time at which the property in the goods is to pass to the buyer."

*Note :—*The words '*ascertained goods*' which occur in Secs. 19 and 58 have not been defined in the Act. Atkin, L. J. *In re Wait* (1927) 1 Ch. 606 at 630 observes that "ascertained" probably means "identified in accordance with the agreement after the time a contract of sale is made."

The rules relating to passing of ownership under a contract to sell goods, which apply in the absence of a contrary intention, may be summarised as follows :

1. In the case of specific goods, in a deliverable state, property in them passes at the time when the contract is made. (Sec. 20).

2. In the case of specific goods, to which something has to be done by the seller to put them in a deliverable state, property passes only when such thing is done, and notice thereof is given to the buyer. (Sec. 21).

3. In the case of specific goods in a deliverable state where the seller is bound to weigh or measure, etc., for ascertaining the price, the property passes only when such weighing etc., is done and notice thereof is given to the buyer (Sec. 22).

4. In the case of unascertained goods sold by description, property passes when goods of that description in a deliverable state are unconditionally appropriated by the seller or his buyer with the consent of the other party. Delivery to a carrier or other bailee for purpose of transmission, without the seller reserving right of disposal, amounts to unconditional appropriation (Sec. 23).

5. In the case of goods delivered to buyer on approval or "on sale or return," property passes when the buyer signifies his approval or acceptance, or keeps the goods for a time longer than what is fixed for such approval, or till after expiry of reasonable time without giving notice of rejection (Sec. 24).

We shall consider in detail the scope of each rule :—

*Rules 1 and 2.*

Section 20 lays down as follows :

"Where there is (i) an unconditional contract (ii) for the sale of specific goods, (iii) in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment of the price or the time of delivery of goods or both is postponed."

Section 21 lays down "where there is a contract (i) for the sale of specific goods and (ii) the seller is bound to do something to the goods, (iii) for the purpose of putting them in a deliverable state, the property does not pass until such thing is done and (iv) the buyer has notice thereof."

What is meant by "deliverable state" is to be found in Sec. 2 (3) which runs as follows :—

"Goods are said to be in a deliverable state when they are in such state that the buyer would under the contract be bound to take delivery of them."

Thus in a case of sale of timber, where according to the custom, the seller has to sever portions rejected by the buyer at his own expense, it was held, that the goods are not in a deliverable state till the timber was so cut, and that ownership did not pass till then. *Acraman v. Morrice* (1849) 137 E.R. 584.

Similarly where some measures of turpentine had to be filled up in receptacles, it was held that the goods were not in a deliverable state till that was done.

*Rule 3. Section 22 lays down :*

"Where there is (i) a contract for the sale of goods (ii) in a deliverable state but (iii) the seller is bound to weigh, measure or test or do some other act or thing with reference to the goods (iv) for the purpose of ascertaining the price, the property does not pass until such act is done and the buyer has notice thereof."

In *Soshi Mohun v. Nobo Kristo* (1879) 4 Cal. 801, the contract was for sale of 975 maunds of rice being the contents of one gola at a certain price per



maund. The buyer paid the entire price, but agreed to remove the rice after weighing the same before a certain date. After delivery was taken of part of the rice the other part was destroyed. It was held that the weighing by the buyer was only for his satisfaction, and not necessary for ascertaining the price, that the property passed to the buyer, and that he had therefore to bear the loss.

**Rule 4.** Section 23 provides as follows ;—

“(1) Where there is a contract for the sale of (i) unascertained or future goods by description and (ii) goods of that description and (iii) in a deliverable state are (iv) unconditionally appropriated to the contract either (v) by the seller with the assent of the buyer or (vi) by the buyer with the assent of the seller, the property in goods thereupon passes to the buyer. Such assent may be express or implied and may be given either before or after the appropriation is made.”

“(2) Where, in pursuance of a contract, (i) the seller delivers the goods to his buyer (ii) or to a carrier or other bailee (iii) (whether named by the buyer or not) ; (iv) for the purpose of transmission to the buyer, and (v) does not reserve the right of disposal, he is deemed to have unconditionally appropriated the goods to the contract.”

It is clear from the section that the appropriation may be made by the buyer or by the seller, though the latter one is more common ; but in either case the appropriation must be made with the assent of the other party.

In *Atkinson v. Bell* (1828) 108 E.R. 1046, the contract was for the sale of machines made by the seller. The seller packed the machines and before sending them asked the buyer to name the conveyance by which they should be sent. There was no reply from the buyer, and it was held that there was no valid appropriation as the buyer had not assented.

Appropriation is generally made by the seller by putting the goods into boxes, or gunny bags, or in the case of fluids into bottles or other suitable receptacles, with the assent of the buyer. The other kind of appropriation is by delivering goods to a carrier or other bailee for transmission. Though in the case of delivery of goods to a carrier, who is not a common carrier, it is not possible to say whether there has been an appropriation with the consent of the buyer, still if the buyer directs the seller to send goods by a common carrier (whether by land or sea), the law holds that the appropriation is made with the assent of the buyer.

**Note.**—A common carrier is one who always remains ready for hiring to transport the goods of anyone who desires to employ him, from one place to another.

**Right of disposal, or (*Jus Disponendi*)** :—In order that delivery to the common carrier may transfer ownership to the buyer not

only should there be an appropriation of goods but it must also be unconditional *i.e.*, the buyer must not have reserved any right of disposal, or 'jus disponendi' over the goods. The law on this point is stated in Sec. 25 as follows :—

"(1) Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled. In such a case notwithstanding the delivery of the goods to a buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled.

(2) Where goods are shipped and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is *prima facie* deemed to reserve the right of disposal.

(3) Where the seller of goods draws on the buyer for the price and transmits the bill of exchange and bill of lading to the buyer together, to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honour the bill of exchange and if he wrongfully retains the bill of lading the property in the goods does not pass to him."

Thus whether or not the seller has retained the right of disposal over the goods, even after he has delivered them to a common carrier, is a question of fact depending on all the surrounding circumstances. But when the railway receipt (R. R.) or bill of lading is made out in the name of the buyer the presumption (which is rebuttable) is that the seller did not retain the right of disposal, and if it is made out in the seller's or his agent's name the presumption is that the right of disposal is retained by him.

Certain types of commercial contracts which can be usefully considered in this context are the following :—

**C. I. F. Contract :—**The letters C.I.F. indicate that the price named in the contract includes the *cost* of goods, *insurance* charges during transit to the buyer, and *freight*. This type of contract is resorted to by traders residing at distant places separated by sea, who want to protect their rights to the utmost. In such cases the seller wants to retain ownership in the goods till payment of the price, while the buyer wants to obtain delivery of goods immediately on paying the price. Therefore what is generally done is as follows :—

"The invoice is made out debiting the consignee with the agreed price for the actual cost, and commission, with the premiums of insurance and the freight, as the case may be, and giving him credit for the amount of the freight which he will have to

pay to the ship-owner, on actual delivery, and for the balance a draft is drawn on the consignee, which he is bound to accept (if the shipment be in conformity with his contract) on having handed to him the Charter party, Bill of Lading and Policy of Insurance. Should the ship arrive with the goods on board he will have to pay the freight which will make up the amount he has engaged to pay. Should the goods not be delivered in consequence of a peril of the sea, he is not called on to pay the freight, and he will recover the amount of his interest in the goods under the policy." *Ireland v. Livingston* (1872) 5 H. L. 395,

A C. I. F. contract is sometimes called a sale of documents but it is not so. It is a contract for sale of insured goods, lost or not lost to be performed by delivering the documents representing the goods. Generally these documents, namely the Bill of Lading, Charter Party, the Policy of Insurance and the draft (Bill of Exchange) will be sent to a Bank at the place of the buyer, and the buyer will have to pay the price to the Bank and take delivery of the documents from it. During the voyage the goods will be at the risk of the buyer, but he will have the benefit of the insurance policy. Even if the seller knows that the goods have been lost at the time of delivery of the shipping documents, he can still compel the buyer to take and pay for them. The buyer is bound to pay the price within a reasonable time after tender of the documents even if the ship had not arrived, and even though he had no opportunity of inspecting the goods. This will not prejudice the buyer's right subsequently to examine the goods on their arrival, and reject them if they are not in accordance with the contract. *Clemens Horst v. Biddell Bros.* (1912) A. C. 18.

**F. O. B. Contract** :—The letters F. O. B. mean free of board, and if the goods are sent by rail the letters F. O. R. (Free on Rail) are used. In this type of contract the seller puts the goods on board a ship, or on rails at his own expense, and the ownership passes at that moment to the buyer. The seller does not insure the goods, and the buyer has to do it if he likes, but the seller must give notice of putting the goods on board the ship, or on rail, to enable the buyer to insure.

**Ex-ship Contract** :—In this type of contract the goods will be at the seller's risk during voyage and he may, if at all, insure the goods for his own protection, but he is not bound to insure them

on behalf of the buyer. *Yangtze Insurance Association v. Lukmanjee* (1918) A. C. 585. The phrase *ex-ship* denotes that the delivery has to be made to the buyer from a ship which has arrived at the port of delivery and has reached a place therein, which is usual for the delivery of goods of the kind in question.

**Rule 5.** Section 24 of the Act lays down as follows—

“When goods are delivered to the buyer on approval or on “sale or return,” or other similar terms, the property therein passes to the buyer—

(a) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction ;

(b) if he does not signify his approval or acceptance to the seller but retains the goods without giving the notice of rejection, then, if a time has been fixed for the return of the goods, on the expiration of such time, and if no time has been fixed on the expiration of a reasonable time.”

Thus in the case of contracts “on sale or return” the risk or ownership would not pass to the buyer until the goods have been accepted, or the period fixed for approval, or a reasonable time after delivery, without such approval being made, has expired.

**Risk prima facie passes with ownership:**—The importance of the question, when property or ownership in the goods passes, is due to the fact that ordinarily risk also passes with ownership. Thus after the passing of the property, if the goods are destroyed by an accident, it is only the buyer that has to bear the loss. The law is expressed in Sec. 26 as follows:—

“Unless otherwise agreed, the goods remain at the seller’s risk until the property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer’s risk whether the delivery has been made or not ;

Provided that, where delivery has been delayed through the fault of either buyer or seller, the goods are at the risk of the party in fault, as regards loss which might not have occurred but for such fault ; Provided also that nothing in this section shall affect the duties or liabilities of either seller or buyer as a bailee of the goods of the other party.”

**Cases in which a non-owner of goods can convey a title:**—As already noticed the general rule is “*Nemo dat quod non habet*” i.e., no one can convey a better title than what he has. If a person having no title to the goods, e.g., thief, sells stolen property, it would be dangerous in the extreme if the law were to recognise the sale on the equitable ground, viz., the hardship to the third party purchaser.

Sec. 27 of the Act lays down the principle thus : "Subject to the provisions of this Act and of any other law for the time being in force, where goods are sold by a person who is not the owner thereof and who does not sell them under the authority or with the consent of the owner, the buyer acquires no better title to the goods than the seller had, unless the owner of the goods is by his conduct precluded from denying the seller's authority to sell."

The section itself makes an exception in cases in which the owner of the goods is precluded by his conduct from denying the authority of the seller to sell. *Pickard v. Sears* (1837) 6 A & E 469. The title to goods so acquired is called *title by estoppel*.

To the rule laid down in Sec. 27 there are the following exceptions :

1. *Sale in market overt* :—In England a person acquires a valid title in the case of goods purchased by him in market overt (*i.e.*, a sale of goods of a kind which are usually sold by the trader, at certain prescribed places, between certain prescribed hours of the day) though the seller has absolutely no title to them. But this rule is peculiar to England and does not apply to India.

2. *Sale by mercantile agent*:—Provided the following conditions are satisfied, a mercantile agent can convey a wholesome title to goods, though he is not the owner thereof :

(i) The person selling the goods must be a mercantile agent. *i.e.*, an agent having in the customary course of business, as such agent, authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods or to raise money on the security of goods. (Sec. 2 Cl. 9). Thus factors, brokers and auctioneers are all mercantile agents.

(ii) He should be in possession of the goods, or of documents of title to the goods. "*Document of title of goods*" according to the Act includes a bill of lading, dock-warrant, warehouse-keeper's certificates, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement, or by delivery, the possessor of the document to transfer or receive the goods thereby represented. (Sec. 2 (4) ).

(iii) The possession of the mercantile agent must be with the consent of the owner. *Folkes v. King* (1923) 1 K.B. 282.

(iv) The mercantile agent must sell in the ordinary course of business as mercantile agent. *Oppenheimer v. Attenborough* (1908). 1 K. B. 221.

(v) The buyer must act in good faith.

(vi) The buyer should not have notice that the seller had no authority to sell (Sec. 27).

3. *Sale by a co-owner* :—A co-owner having sole possession of the goods, with the permission of the co-owners, passes a good title to the buyer, purchasing in good faith and without notice that the seller had no authority to sell. (Sec. 28).

4. *Sale by person with voidable title* :—A person who has obtained possession of goods under a contract which is voidable on the ground of fraud, misrepresentation, coercion, or undue influence, can convey a good title to the buyer, acting in good faith and without notice of the seller's defective title, provided the sale takes place before the voidable contract is set aside (Sec. 29)

5. *Sale by seller in possession of goods after sale* :—Where a person, having sold goods continues or is in possession of the goods, or of document of title to the goods, the delivery or transfer by that person or by a mercantile agent for him of the goods or documents of title under any sale, pledge or other disposition thereof shall have the same effect as if made by the owner, provided the person receiving the same receives in good faith and without notice of the previous sale. (Sec. 30 (1) ).

6. *Sale by buyer in possession of goods* :—A buyer in possession of goods under a sale, or an agreement to sell can similarly convey a good title by way of sale, or pledge, to a person acting in good faith and without notice of any lien or other right of the original seller in respect of the goods.

7. According to Sec. 54, Clause 3 of the Act, an unpaid vendor of goods, who has exercised his right of lien or stoppage in transit, can even though the ownership in them has passed to the buyer, re-sell the goods and convey a valid title to another buyer, though no notice of resale has been given to the original buyer.

### Performance of the Contract

*Delivery* :—Sec. 2 (2) of the Act defines 'delivery' as :

"voluntary transfer of possession from one person to another"; and Sec. 33 of the Act lays down that "Delivery of goods sold may be made by

doing anything which the parties agree shall be treated as delivery, or which has the effect of putting the goods in the possession of the buyer, or of any person authorised to hold them on his behalf."

Therefore it is clear that in addition to transfer of physical possession, any other act which the parties agree to treat as equivalent thereto has the effect of delivery.

Further Sec. 39 (1) lays down :

"Where in pursuance of a contract of sale the seller is authorised or required to send the goods to the buyer, delivery of goods to a carrier, whether named by the buyer or not, for the purpose of transmission to the buyer, or delivery of the goods to a wharfinger for safe custody is *prima facie* deemed to be a delivery of the goods to the buyer."

Delivery of goods may therefore be effected in any of the following ways :

(i) *Physical or actual delivery*:—In this case the khas or physical possession of the goods is handed over by the seller to the buyer.

(ii) *Symbolical delivery*:—This is resorted to when physical delivery is not possible, and delivery is made by delivering some symbol, which would carry with it the real possession or control over the goods ; for example delivery of a bill of lading properly endorsed, or delivery of the key of a warehouse.

(iii) *Constructive delivery or attornment*:—In this kind of delivery there is neither change of physical possession of goods, nor delivery of a symbol, but there is only an acknowledgment by the person in possession that he holds them on behalf of another ; in other words, there is only a change in the legal character of possession. This type of delivery may be effected in three ways :

(a) Where the buyer, who is already in possession of goods as bailee of the seller, holds them as his (buyer's) own, after the sale.

(b) Where the seller, who is in possession of goods, holds them as the bailee of the buyer after the sale ; and

(c) where a third party like a warehouseman, who was holding the goods as a bailee of the seller, agrees after sale to hold them as the bailee of the buyer. Sec. 36 (3) lays down that where the goods at the time of sale are in the possession of a third person, there is no delivery by seller to buyer, unless and until such third person acknowledges to the buyer that he holds the goods on his behalf.

**Rights and duties of the seller and the buyer.**

*Duties of the seller:* They are enumerated below :—

(i) The first and foremost duty of the seller is to deliver the goods in accordance with the terms of the contract of sale (Section 31).

(ii) In the absence of an agreement to the contrary, delivery of the goods and payment of the price are concurrent conditions; that is to say, the seller shall be ready and willing to give possession of the goods to the buyer in exchange for the price and *vice versa*. (Sec. 32). In other words unless the contract for sale is on credit the seller is not bound to deliver the goods without receiving the price.

(iii) In the absence of an express contract to the contrary, the seller is not bound to deliver the goods unless the buyer applies for delivery at a reasonable hour (Secs. 35, and 36 (4) ).

(iv) In the absence of any stipulated time the delivery of the goods by the seller must be made within a reasonable time (Sec. 36 (2) ).

(v) Whether it is for the buyer to take possession of the goods, or for the seller to send them to the buyer, is a question depending on the contract express or implied between the parties. In the absence of a contract to the contrary, the seller is bound to deliver the goods sold at the place at which they are at the time of sale, and the goods agreed to be sold at the place at which they are at the time of the agreement to sell, or if not then in existence, at the place at which they are manufactured or produced (Sec. 36 (1) ).

(vi) All expenses of, and incidental to, putting the goods into a deliverable state shall be borne by the seller (Sec. 36 (5) ).

(vii) In the absence of any contrary instructions from the buyer, the seller is bound to make a reasonable contract with the carrier for safe transmission, or if the delivery is to a wharfinger, with him, for safe custody and re-delivery. If the seller commits default in this respect the buyer may decline to treat it as a valid delivery binding upon him (buyer), or may hold the seller liable in damages (Sec. 39 (2) ).

(viii) In the absence of a contract to the contrary, when the goods have to be sent by sea-transit, and if it is usual in those



circumstances to insure them, the seller is bound to give sufficient notice to enable the buyer to insure the goods during voyage. If the seller commits any default in this respect, the goods will be at the risk of the seller (Sec. 39 (3) ).

Since the duties of a seller are reciprocal to the rights of the buyer, we shall next deal with them.

*Rights of the buyer:*—(i) The buyer is entitled to have delivery of the goods as per terms of the contract. The delivery must be made of the exact quantity purchased by the buyer. *Hart v. Mills* (1846) 15 M. & W. 85. The rights of the buyer, in cases of delivery of goods, of a wrong quantity or of wrong description, are laid down, subject to any trade usage or agreement to the contrary, as follows :—

(a) If the goods are less than the quantity specified the buyer may reject them. If he accepts them he should pay them at the contract rate.

(b) If the seller delivers goods larger than the quantity specified, the buyer may accept the goods included in the contract, and reject the rest, or he may reject the whole. If the buyer accepts the whole of the goods so delivered, he shall pay for them at the contract rate.

(c) If the seller delivers the goods which he contracted to sell, mixed with goods of a different description, the buyer may accept those in accordance with the contract, and reject the rest, or may reject the whole (Sec. 37).

(ii) The buyer is entitled to claim delivery of the whole goods and is not bound to accept delivery of them in instalments (Sec. 38 (1) ).

(iti) In the case of delivery by instalments, whether the default of the buyer in paying for one or more instalments, or the default of the seller in delivering one or more instalments, gives a right to repudiate the entire contract, or gives rise only to a claim for compensation, is a question depending on the terms of the contract, and circumstances of the case. (Sec. 38 (2) ). *Mersey Steel and Iron Coy. v. Naylor* (1884) 9 A.C. 434. (supra).

(iv) When the goods are delivered or tendered for delivery, the buyer can claim reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract. (Sec. 41).

(v) Where the buyer has the right to accept or return the goods, he can accept the same either by (a) intimation to the seller, or (b) retaining the goods without intimating rejection, till after the expiry of a reasonable time, or (c) doing any act in relation to the goods inconsistent with the ownership of the seller e.g., by a resale or pledge by the buyer (Sec. 42).

(vi) Where the buyer having the right to do so, refuses to accept the goods, it is enough if he intimates the same to the seller, and he is not bound to return them to the seller : (Sec. 43).

(vii) In cases of breach of warranty, the buyer can :

- (a) set up against the seller the breach of warranty, in diminution or extinction of the price ; or
- (b) sue the seller for damages for breach of warranty ; or
- (c) in case of further damage arising from the breach of warranty, for which diminution or extinction of price has already been claimed, the buyer can also sue for the additional damage (Sec. 59).

(viii) The buyer can sue the seller in damages for wrongfully neglecting or refusing to deliver goods (Sec. 57).

The measure of damages recoverable by the buyer is the difference between the contract price of the goods, and the market price, at the time when the goods ought to have been delivered, if there is an available market. The sub contracts entered into by the buyer cannot, as a general rule, be used to increase or minimise his damages, as the sub contracts are incidental matters with which the seller has nothing to do. *Williams Bros. v. E. T. Agins Ltd.* (1914) A. C. 510. If the buyer wants to claim in excess of that, which represents the difference between the contract price and the market price he must prove facts which will bring the case within the second branch of Sec. 73, Contract Act (supra).

(ix) In cases of anticipatory breach, the buyer can either treat the contract as subsisting, or terminate the contract and sue for damages (Sec. 60).

(x) Where the buyer has already paid the price, and the seller commits default in delivering the goods, the buyer can claim refund of the price with the interest on the same, at such rate as the court thinks fit from the date on which the price was paid (Sec. 61).

(xi) Subject to the provisions of the Specific Relief Act, the court may, in a proper case, grant specific performance of a contract for the delivery of ascertained or specific goods (Sec. 58)

This remedy, being discretionary, will not be granted unless it is proved that damages would not be an adequate remedy. Thus in the case of goods generally available in the market, specific performance will not be granted. But if the goods or articles agreed to be sold have special value, or rare qualities *e.g.*, a portrait by a dead artist, or a literary work which is out of print etc., specific performance may be granted.

*Duties of the buyer* :—(i) Since delivery of goods and payment of price are concurrent conditions, the buyer should be ready and willing to pay the price in exchange for possession of the goods. (Sec. 32).

(ii) Where the seller of goods agrees to deliver them at his own risk, at a place other than that where they are when sold, the buyer shall, nevertheless, unless otherwise agreed, take any risk of deterioration in the goods, necessarily incident to the course of transit (Sec. 40).

(iii) Where the buyer fails to take delivery of the goods within a reasonable time after being asked to do so, he will be liable to the seller for any loss caused by such neglect, and also for a reasonable charge for the care and custody of goods. This right of the seller will not however affect the rights available to him, in case the refusal of the buyer amounts to a repudiation of the contract (Sec. 44).

Closely connected with the duties of the buyer are the rights of the seller, and we shall therefore consider them next.

*Rights of the seller* :—(i) The seller can sue for damages, where the buyer wrongfully neglects or refuses to accept, and pay for the goods (Sec. 56).

(ii) Where the ownership in the goods has passed to the buyer, and the buyer neglects or refuses to pay for the goods, the seller can sue him for the price. (Sec. 55 (i) ).

(iii) Even though ownership in goods has not passed, if the buyer agreed to pay the price independent of delivery of the goods, and failed to do so, the seller can sue for the price of the goods, though the goods have not been delivered (Sec. 50 (ii) ).

(iv) While suing for the price, the seller can also claim interest on the same, from the date on which the price, is payable. Sec. 61 (ii) (a) ).

## SALE OF GOODS

(v) If the seller is an unpaid vendor, within the meaning of the Act, he is entitled to the following rights, notwithstanding that the property in the goods has passed to the buyer, viz. (a) a lien on the goods for the price, while he is in possession of them (b) in case of the insolvency of the buyer, a right of stopping the goods in transit, after he has parted with the possession of them, (c) a right of re-sale, (Sec. 46). These three rights will be considered in detail separately.

(vi) In cases where the property in the goods has not passed to the buyer, and the seller is an unpaid vendor (within the meaning of the Act) the seller has, besides other remedies, a right of withholding delivery similar to, and co-extensive with his rights of lien, and stoppage in transit (Sec. 46 (ii) ).

### Rights of an unpaid seller or vendor

*Who is an unpaid seller :—*Sec. 45 (i) of the Act lays down as follows :—

“The seller of goods is deemed to be an ‘unpaid seller’ within the meaning of the Act:—

- (a) when the whole of the price has not been paid or tendered ;
- (b) when the bill of exchange, or other negotiable instrument, has been received as conditional payment, and the condition on which it was received has not been fulfilled, by reason of the dishonour of the instrument or otherwise.”

*Unpaid seller's Lien :—*“Subject to the provisions of this Act, the unpaid seller of goods who is in possession of them, is entitled to retain possession of them until payment or tender of the price in the following cases, namely:

- (a) Where the goods have been sold without any stipulation as to credit;
- (b) Where the goods have been sold on credit, but the term of credit has expired;
- (c) Where the buyer becomes insolvent.” (Sec. 47 (1) ).

Section 2 (8) of the Act defines an “insolvent” as a person “who has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due, whether he has committed an act of insolvency or not.”

The lien of an unpaid seller is a particular lien, and it is a personal right which can be exercised only by him and

not by his assignees or his creditors. This right is also indivisible, and so the buyer is not entitled to claim delivery of a portion of the goods on payment of proportionate price. The unpaid vendor may exercise his lien notwithstanding that he is in possession of the goods as agent or bailee for the buyer (Sec. 47 (ii)). Further this right of lien is available even after part delivery of the goods has been made, unless such part delivery is made under such circumstances as to show an agreement to waive the lien. (Sec. 48). It may also be noted that an unpaid seller does not lose his lien by reason only that he has obtained a decree for the price of the goods (Sec. 49 (ii)).

*Unpaid seller's lien how lost* :—In the following cases an unpaid seller loses his lien :

- (i) When he delivers the goods to a carrier, or other bailee, for the purpose of transmission to the buyer, without reserving the right of disposal. In this case the right of lien is no doubt lost, but the right of stoppage in transit will be available.
- (ii) Where the buyer or his agent lawfully obtains possession of the goods.
- (iii) By waiving the right of lien. (Sec. 49 (i)).
- (iv) Where part delivery of goods has been made to the buyer under circumstances indicating an agreement to waive the lien (Sec- 48).

*Stoppage in transit* :—An important right which is available to an unpaid seller is the right of stoppage in transit. This right consists in preventing the goods from being delivered to the buyer, and resuming their possession while in transit, and retaining them till the price is paid. It comes into existence only when 'lien' is not available, *i.e.*, when the unpaid seller has parted with the possession of goods. In order that goods may be said to be in 'transit' they should be in the possession of a third party *e.g.*, a railway company, or a shipping company, after the seller has parted with their possession, and before the buyer has acquired possession of them. This right, no doubt, resembles the right of lien, in that both of them are available even though the ownership in the goods has passed to the buyer, but there are points of difference between the two. They are:—

(i) Lien is available only when the goods are in the possession of the unpaid seller, while stoppage in transit is available only after the seller has parted with possession of the goods.

(ii) Right of stoppage in transit is available only when the buyer becomes an insolvent, but not merely because the period for which credit was given has expired ; but right of lien is available, even when the buyer is not an insolvent provided the credit period has expired and the price has not been paid.

The right of stoppage in transit can be exercised subject to the following conditions :—

(i) the seller must be an unpaid seller, *i.e.*, the price must have been unpaid in full, or in part, whether or not credit is given ; and

(ii) the buyer must have become an insolvent ; and

(iii) the seller must have parted with the possession of goods and

(iv) the goods must be in transit (S. 50).

This right can be exercised only subject to the provisions of the Act. If therefore before the right of stoppage in transit has been exercised, the buyer obtains delivery of the railway receipt, or other document of title, and assigns the same to a *bona fide* purchaser for value, the said right is lost.

*Duration of transit* :—Since the right of stoppage in transit can be validly exercised only during 'transit' the question of duration of transit assumes great importance. Section 51 of the Act has answered the question in the following way :—

“(I) Goods are deemed to be in course of transit from the time when they are delivered to a carrier or other bailee for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from such carrier or other bailee.

(2) If the buyer or his agent in that behalf obtains delivery of the goods before their arrival at the appointed destination, the transit is at an end.

(3) If after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent, that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent, the transit is at an end, and it is immaterial that a further destination for the goods may have been indicated by the buyer.

- (4) If the goods are rejected by the buyer and the carrier or other bailee continues in possession of them, the transit is not deemed to be at an end, even if the seller has refused to receive them back.
- (5) Where goods are delivered to a ship chartered by the buyer, it is a question depending on the circumstances of the particular case, whether they are in possession of the master as a carrier or agent of the buyer.
- (6) Where the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf, the transit is deemed to be at an end.
- (7) Where part delivery of the goods has been made to the buyer or agent in that behalf, the remainder of the goods may be stopped in transit, unless such part delivery has been given in such circumstances as to show an agreement to give up possession of the whole of the goods."

In *G. I. P. Railway v. Hanumandas*, (1899) 14 Bom. 57 goods were delivered by the seller to a railway company for being carried to their destination. After they reached the destination the endorsee of the railway receipt paid the freight to the company and loaded the goods in his carts, but before the carts left the compound of the railway station the company received notice from the seller requiring the company to stop the goods, on the ground of the buyer's insolvency. It was held that the transit was at an end by the time the notice was served, and that the right of stoppage in transit could not be exercised.

*How stoppage in transit is effected* :—The law is laid down in Sec. 52 as follows :—

- "(i) The unpaid seller may exercise his right of stoppage in transit
- (a) either by taking actual possession of the goods, or
  - (b) by giving notice of his claim to the carrier, or other bailee in whose possession the goods are.
- (ii) Such notice may be given either to the person in actual possession of the goods, or to his principal. In the latter case, the notice, to be effectual, shall be given at such time and in such circumstances that the principal, by the exercise of reasonable diligence, may communicate it to his servant or agent in time, to prevent a delivery to the buyer.
- (iii) When notice of stoppage in transit is given by the seller to the carrier, or other bailee in possession of the goods, he shall re-deliver the goods to or according to the directions of the seller. The expenses of such a re-delivery shall be borne by the seller."

*Effect of sub-sale or pledge by the buyer* :—The general rule is that the unpaid seller's right of lien, or stoppage in transit, is not affected by any sale or other disposition of the goods which the buyer may have made, unless the seller has assented thereto,

but to this rule, there are some exceptions : (i) where a document of title to the goods has been issued or lawfully transferred to any person as buyer or owner of the goods, and that person transfers the document to a purchaser in good faith and for valuable consideration, the unpaid seller's right of lien or stoppage in transit is destroyed ; (ii) where the document of title to the goods issued or lawfully transferred to the buyer has been transferred by him, to a *bona fide* purchaser, for consideration, by way of pledge, the right of lien or stoppage in transit, can only be exercised subject to the right of the pawnee. In the latter case the seller may require the pawnee to have the amount secured by the pledge satisfied in the first instance, as far as possible, out of any other goods, or securities of the buyer in the hands of the pawnee and available against the buyer (Sec. 53).

**Right of Re-sale** :—In addition to the rights of lien and stoppage in transit the unpaid vendor has got the valuable right of re-sale of the goods which are the subject-matter of the contract. The rules regarding the right of re-sale are laid down in Sec. 54 as follows :—

“(1) Subject to the provisions of this section, a contract of sale is not rescinded by the mere exercise by an unpaid seller of his right of lien or stoppage in transit.

(2) Where the goods are of a perishable nature, or where the unpaid seller who has exercised his right of lien or stoppage in transit gives notice to the buyer of his intention to re-sell, the unpaid seller may, if the buyer does not within a reasonable time pay or tender the price, resell the goods within a reasonable time and recover from the original buyer damages for any loss occasioned by his breach of the contract, but the buyer shall not be entitled to any profit which may occur on the re-sale. If such notice is not given, the unpaid seller shall not be entitled to recover such damages and the buyer shall be entitled to the profit, if any, on the re-sale.

(3) Where an unpaid seller who has exercised his right of lien or stoppage in transit resells the goods, the buyer acquires a good title thereto as against the original buyer, notwithstanding that no notice of the re-sale has been given to the original buyer.

(4) Where the seller expressly reserves a right of re-sale in case the buyer should make default, and on the buyer making default re-sells the goods, the original contract of sale, is thereby rescinded, but without prejudice to any claim which the seller may have for damages.”

**Auction sales** :—The Indian Sale of Goods Act has laid down the law regarding auction sales in Sec. 64 as follows :—

“In the case of sale by auction;



(1) Where goods are put up for sale in lots, each lot is *prima facie* deemed to be the subject of a separate contract of sale ;

(2) the sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner ; and until such announcement is made, any bidder may retract his bid ;

(3) a right to bid may be reserved expressly by or on behalf of the seller and where such right is expressly so reserved, but not otherwise, the seller or any one person on his behalf may, subject to the provisions hereinafter contained, bid at the auction ;

(4) where the sale is not notified to be subject to a right to bid on behalf of the seller it shall not be lawful for the seller to bid himself or employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person ; and any sale contravening this rule may be treated as fraudulent by the buyer ;

(5) the sale may be notified to be subject to a reserved or upset price ;

(6) if the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer."

It should be noted that an agreement between bidders not to bid against each other, called '*knock out*', is not illegal.



## CHAPTER XIX

### PARTNERSHIP

*History of the Law:*—A contract of partnership is a special contract, which is of great importance to businessmen. The Indian Law was originally contained in Chapter XI of the Contract Act, which has been repealed, and replaced by the Indian Partnership Act, (Act IX of 1932). The law in England is to be found in the English Partnership Act of 1890. The Indian Act is substantially a copy of the English Act, with certain alterations made to suit the peculiar conditions prevailing in India. The Indian Act came into force on 1st October 1932, and the sections referred to hereafter relate to the Indian Partnership Act.

*Points of difference between the English and the Indian Acts:*—

1. Greater prominence is given in the Indian Act to the personality of the firm, than in the English Act. Thus the provisions relating to introduction, expulsion, retirement, insolvency and death of partners are to be found scattered in the English Act, but they are all grouped in Chapter V of the Indian Act, entitled Incoming and Outgoing Partners.

2. The Indian Act specifically mentions that the goodwill of a firm is an asset, and provides for its disposal during dissolution of the firm, but the English Act has not done so.

3. Chapter VII of the Indian Partnership Act deals with the registration of firms. But the English Act has no corresponding chapter, as the law relating to registration of firm names is to be found in the Registration of Business Names Act of 1916.

**Definition of Partnership :**—There are several definitions of partnership, but it would suffice to note a few of them.

The English Partnership Act defines partnership as “the relation which subsists between persons carrying on business in common with a view of profit.”

Sir F. Pollock defines partnership as “the relation which subsists between persons who have agreed to share the profits of a business carried on by all, or any of them on behalf of all of them.”

Section 239 of the Contract Act (repealed), defines the term as "the relation which subsists between persons who have agreed to combine their property, labour or skill in some business, and to share the profits thereof between them."

Section 4 of the Indian Partnership Act defines thus : "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all, or any of them acting for all. Persons who have entered into partnership with one another are called individually 'partners' and collectively 'a firm' and the name under which their business is carried on is called the 'firm name'."

Each definition gives importance to some feature of the partnership, but all of them agree with regard to its essentials. They are as follows :

1. Partnership is the name for the abstract legal relationship between the partners, and not the collective name of all partners, as is sometimes wrongly supposed.

2. In order that this relation of partnership may arise there should be two or more partners. The minimum number of partners for a firm is two, and the maximum number is fixed by the Indian Companies Act as ten in the case of firms carrying on the business of banking, and twenty in the case of other firms. A firm consisting of more than the prescribed number of partners is illegal. If a firm is formed for an illegal purpose, then again the partnership is illegal. The effect of illegality is that it prevents an action being brought for breach of the partnership agreement, or for accounts.

3. Partnership is the result of an agreement between the partners, and does not arise from status (as in the case of members of a joint Hindu family), or by mere joint acquisition of property.

4. The agreement between the partners must be to combine property, labour or skill. Though ordinarily every partner contributes either capital or skill, yet according to a strict view of the law such contribution is not necessary. In order that a person may become a partner it is enough if there is an agreement on his part undertaking the liabilities of the firm.

5. The agreement between the partners must be to carry on some 'business', which is defined in Section 2 (b) of the Indian

Partnership Act as including "every trade, occupation or profession." Though the word business generally conveys the idea of numerous transactions, still Section 8 makes it clear that a person may become a partner with another in particular adventures or undertakings. This kind of partnership is called "particular partnership."

6. The business should be carried on by all, or any of them on behalf of all of them. The foundation of the law of partnership is agency, and it is therefore said that "the law of partnership is a branch of the law of principal and agent." The peculiar position of a partner is that he is an agent and a principal both at once. He is an agent inasmuch as he can bind the other partners by his acts in connection with and within the scope of the partnership business. *Baird's case* (1870) L. R. 5 Ch. App. 725. He is a principal inasmuch as he is also bound by similar acts of the other partners. Therefore it is this idea of agency or representation of each partner by all or some of the partners in the partnership business, that is most characteristic of partnership and distinguishes it from other legal relationships.

7. The agreement to carry on business must be with a view to share profits between them. 'Profits' strictly speaking means 'net profits' i.e., "excess of returns over advances, the excess of what is obtained over the cost of obtaining it." It is incorrect to speak of total receipts, or gross returns of business, as 'gross profits'.

*Test of partnership* :—Generally speaking, no one would enter into partnership with another to suffer losses, though perhaps that may be inevitable sometimes. But the real difficulty arises when Courts are called upon to decide the existence or absence of a partnership in a case where certain persons are proved to be dividing profits among themselves.

In *Waugh v. Carver* (1793) 126 E. R. 525 it was held that all persons sharing profits in a business, incurred the liability of partners, though no partnership was contemplated between them. This principle was followed in England till 1860 when a death blow was given to it by the House of Lords in deciding the famous case of *Cox v. Hickman* (1860) 8 H. L. C. 268. In this case certain traders being in difficulties assigned all their properties to trustees, empowering them to carry on the said business. One Cox, who was a creditor trustee, did not take part in that business, but he was sought to be

made liable as a partner for liabilities contracted by the trustee. It was held by the House of Lords that he was not liable, on the ground that the right to participate in the profits is in general a sufficiently accurate test for deciding whether a person is in law a partner or not, but that it is not conclusive. It was held that the real test of partnership liability was whether "the trade was carried on his behalf i.e., he stood in the relation of principal towards the persons acting ostensibly as the traders, by whom the liability has been incurred and under whose management the profits have been made."

Thus it is the agreement to share the losses arising from the conduct of other persons that is more important than the actual sharing of profits.

This principle for determining the existence of partnership has been laid down in Sec. 6 as follows :—

"In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

*Explanation 1.* :— The sharing of profits or of gross returns arising from property by persons holding a joint or common interest in that property does not of itself make such persons partners....."

**Partnership distinguished from other legal relationships :—**  
*Explanation 2* to Section 6 has removed all doubts which might be entertained regarding certain relations which resemble partnership, but are quite distinct from it. Thus it says :—

"The receipt by a person of a share of the profits of a business, or of a payment contingent upon the earning of profits or varying with the profit earned by a business, does not of itself make him a partner with the persons carrying on the business and in particular, the receipt of such share or payment—

- (a) by a lender of money to persons engaged or about to engage in any business,
- (b) by a servant or agent as remuneration,
- (c) by the widow or child of a deceased partner, as annuity, or
- (d) by a previous owner of the business as consideration for the sale of the goodwill or share thereof does not itself make the receiver a partner with the persons carrying on the business."

1. It may therefore be noted that a partnership is different from co-ownership. Thus if two persons who jointly own a house let out the same to a tenant and divide the rents, they are only co-owners but not partners with respect to the house or rent, because the idea of representation of one person by the other is absent. The points of difference between the two are :

**PARTNERSHIP.**

1. It arises from contract.
2. It involves the sharing of profits and losses.
3. A partner is entitled to claim a share in the surplus assets of the firm, but not a share in the properties of the firm *in specie*.
4. One partner cannot assign his share to a stranger without the consent of the other partners.
5. Every partner is bound by the acts of the other partners in the business of the agency.

**CO-OWNERSHIP.**

1. It need not necessarily arise from contract. It may also arise by status, *e.g.*, several persons inheriting the property of deceased individual.
2. It does not always involve the sharing of profits or losses.
3. A co-owner can claim division of the joint property *in specie*.
4. One co-owner can alienate his share to strangers without the consent of other co-owners.
5. A co-owner is not bound by any liabilities incurred by the other co-owners without his consent.

II. A creditor who shares only in the profits of a business in lieu of interest, or in addition to interest, is not a partner.

III. A servant receiving a share in the profits of the business in lieu of or in addition to his wages, is not a partner.

IV. *Members of a club are not partners* :—An ordinary social club or society is not a partnership because it is not formed to acquire profit. Therefore the managing committee has no authority to pledge the credit of the members, and make them liable for the debts contracted. It is only the persons that actually purchase the goods on credit that will be liable in such a case, and the other member will not be liable to contribute to the losses of the club beyond the subscription payable according to rules.

V. *A firm is different from a corporation or an incorporated company* :—A corporation *e.g.*, a company registered under the Indian Companies Act is not a firm. The points of difference between a company and a firm are as follows :—

**FIRM**

1. A firm is not a legal entity, but only consists of the individual partners for the time being.

**INCORPORATED COMPANY**

1. A company is a corporate body and has got an artificial personality, apart from the members or shareholders constituting it.

**FIRM**

2. The liabilities of a firm can be enforced against each partner personally.
3. A partner cannot assign his share to a stranger, without the consent of the other partners.
4. Death, retirement or insolvency of a partner dissolves the firm.

**INCORPORATED COMPANY**

2. In the case of a company with limited liability, the liabilities of the company have to be realised from the assets of the company, and a shareholder is not liable to contribute more than the value of the shares taken by him.
3. Generally speaking, a shareholder can assign his shares to any one he pleases.
4. Death, retirement or insolvency of a shareholder does not affect the existence of a company.

**VI. Partnership Firm is different from a Hindu Joint Family Trading Firm :—**An association of individuals which carries on business and which resembles a partnership firm, is the Hindu Joint family firm consisting of the undivided members of a Hindu family carrying on trade. For a long time a doubt was entertained whether the provisions of the law of partnership could or could not be applied to such joint family firms. The question is undoubtedly of great importance because there are several Hindu families in India, whose family occupation is trade. Before a family can be styled as a joint family trading firm three conditions must be satisfied : 1. there must be a joint family within the meaning of Hindu Law ; 2. the business must be a family business *i.e.*, one carried on for the benefit of all the members of the family to acquire profit ; 3. the capital for the business must belong to the joint family. Such a Joint Family firm resembles a partnership firm in certain respects, but it has been laid down in several decisions, as well as by Section 5 that a Hindu Joint family trading firm is not a firm within the meaning of the Act. The chief reason for that rule is that every male member in a trading family becomes a member of that family firm by virtue of his birth, and not by an agreement between himself and other members, which is the foundation of a partnership firm. Section 5 runs as follows :—

"The relation of the partnership arises from contract and not from status ; and in particular the members of a Hindu undivided family carrying on a family business as such, or a Burmese Buddhist husband and wife carrying on business as such are not partners in such business."

Therefore if the members of a Hindu trading family or a Burmese Buddhist husband and wife, want to be governed by the provisions of the Partnership Act, they should enter into an agreement of partnership. Otherwise they will simply be governed by their personal laws.

*Points of difference between a Partnership Firm and Joint Hindu Family Firm :—*

#### *PARTNERSHIP FIRM*

1. It is the result of an agreement between the members.
2. The death of a member disrupts the unity and dissolves the firm.
3. A member of either sex can be a partner in a firm.
4. A new member can be admitted only with the consent of the other partners.
5. Every partner has a right to pledge the credit of the firm for the partnership business.
6. Each partner is personally liable for the debts of the firm.
7. Every partner can ask for dissolution and accounts of the firm.

#### *JOINT FAMILY FIRM*

1. It is not the result of an agreement, but the result of status.
2. It is not dissolved by the death of any male member.
3. It is only male members that can be members of a joint family firm.
4. There will be constant and automatic additions to the joint family firm, by the birth of male children.
6. It is only the manager of the joint family firm that can contract a debt so as to bind the other members.
6. It is the manager that is personally liable for the firm's debts. Other members of the family are liable only to the extent of their interest in the joint family firm, unless they join with the manager in contracting the debts, or ratify the same subsequently.
7. The only right of a member is to ask for partition of the existing assets, and not to demand an account from the manager for his past dealings.

*Partnership and Firm :—*As already noticed partnership is the name given to the abstract legal relationship between the partners, while firm is only an abbreviated form for collectively designating all the partners. It should therefore be remembered that a firm has not got any legal existence independent of the existence of its members. That is why according to law



a firm consisting of A and B cannot be a creditor or debtor of A or B. The only right of A or B in such a case is to file a suit against the other partner for dissolution and settlement of accounts and not to claim a particular amount as the creditor of the firm. But traders are nevertheless in the habit of treating a partner as a debtor or creditor of the firm, but that is only a mercantile usage recognised for the sake of convenience, but which has no recognition in a Court of Law.

The points of difference between a legal and a mercantile notion of a firm are :—(1) While a firm is not a person in the eye of law, it is looked upon as a person, apart from its individual members, in the mercantile world. (2) While a partner can be a debtor or a creditor only of the other partners according to legal notion, the mercantile notion permits a partner to be a debtor or a creditor of the firm. (3) On the death or retirement of a partner the firm gets dissolved according to law, but according to the mercantile notion a firm continues to exist notwithstanding the death or retirement of a partner.

*Firm Name* :—The name under which partners carry on their business is called the firm name, and it may be anything, either imaginary or real. For instance a partnership firm may call itself a 'company', though in fact it is not a company registered under the Indian Companies Act. But a partnership firm cannot add the word 'limited' after its name, because the Companies Act makes it clear that it is only Companies with limited liability registered under that Act, that enjoy the privilege of having the liability of their members limited. The only restriction imposed by the Act upon the partners in the matter of selecting a firm name is that they should not use words Emperor, King, Queen etc., implying the sanction or patronage of the Government, except with the express permission of the Central Government. [Section 58 (ii) ]. The other restriction imposed is that it should not be made to so closely resemble the name of another firm, carrying on identical business, for the purpose of deceiving customers into thinking that the new firm is the same as the firm already existing. Where there is no chance of misleading or confusing the public, a mere similarity of names would not entitle any person or a firm to restrain another firm from using any name it likes.

*Consideration for an agreement of partnership* :—Since every partner is an agent and a principal at the same time with respect

to the other partners, the promise of each of them to be a partner with others involves a detriment, which is sufficient consideration and makes the agreement binding upon each of them. Where there is already a going firm, and an outsider is admitted as a partner thereof for a particular period, in consideration of his paying a certain premium to the other partners, a question may arise as to what should happen to the premium, if the firm happens to be dissolved earlier. Section 51 of the Act lays down as follows :—

“Where a partner has paid a premium on entering into a partnership for a fixed term, and the firm is dissolved before the expiration of that term otherwise than by the death of a partner, he shall be entitled to the repayment of the premium or of such part thereof as may be reasonable, regard being had to the terms upon which he became a partner and to the length of time during which he was a partner, unless.—(a) the dissolution is mainly due to his own misconduct, or (b) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.”

**Rights of minor admitted to benefits of partnership :—**We have already noticed that a minor has no capacity to enter into a contract, and any contract with him is void. Since a partnership contract implies an agreement to be bound by the acts and contracts of the other partners, it is void according to Indian Law, if any of the parties to it is a minor. Therefore a firm cannot be legally formed if one of the partners is a minor. But if the minor is admitted to the benefits of a firm, already in existence, the Act declares that the contract is valid, and will be enforced subject to certain limitations. The rights and liabilities of a minor, who has been so admitted to the benefits of a partnership are laid down by Sec. 30 as follows :—

“1. A person who is a minor according to the law to which he is subject may not be a partner in a firm, but with the consent of all the partners for the time being, he may be admitted to the benefits of partnership.

2. Such minor has a right to such share of the property and of the profits of the firm as may be agreed upon, and he may have access to and inspect and copy any of the accounts of the firm.

3. Such minors' share is liable for the acts of the firm but the minor is not personally liable for any such act.

4. Such minor may not sue the partners for an account or payment of his share of the property or profits of the firm, save when severing his connection with the firm, and in such a case the amount of his share shall be determined by a valuation made as far as possible in accordance with the rules contained in Section 48.

Provided that all the partners acting together or any partner entitled to dissolve the firm upon notice to other partners may elect in such suit to dissolve the firm, and thereupon the Court shall proceed with the suit as one for dissolution and for settling accounts between the partners and the amount of the share of the minor shall be determined along with the share of the partners.

5. At any time within six months of his attaining majority or of his obtaining knowledge that he had been admitted to the benefits of partnership, whichever date is later, such person may give public notice that he has elected to become or that he has elected not to become a partner in the firm, and such notice shall determine his position as regards the firm :

Provided that, if he fails to give such notice, he shall become a partner in the firm on the expiry of the said six months.

6. Where any person has been admitted as a minor to the benefits of partnership in a firm the burden of proving the fact that such person had no knowledge of such admission until a particular date after the expiry of six months of his attaining majority shall lie on the persons asserting that fact.

7. Where such person becomes a partner,—

- (a) his rights and liabilities as a minor continue up to the date on which he becomes a partner, but he also becomes personally liable to third parties for all acts of the firm done since he was admitted to the benefits of partnership, and
- (b) his share to the property and profits of the firm shall be the share to which he was entitled as a minor.

8. Where such person elects not to become a partner,—

- (a) his rights and liabilities shall continue to be those of a minor under this section up to the date on which he gives public notice,
- (b) his share shall not be liable for any acts of the firm done after the date of the notice, and
- (c) he shall be entitled to sue the partners for his share of the property and profits in accordance with sub-section (4).

9. Nothing in sub-sections (7) and (8) shall affect the provisions of section 28."

*Note:*—In England an infant may be a partner in a firm, though he cannot be sued for the debts of the firm contracted during his minority. Further the minor partner has the option of affirming or avoiding the contract and incidental obligations, within a reasonable period after attaining majority. But as regards his right to demand accounts and settlement of his share he is in the same position as any other partner. Further in England a minor who has not repudiated the contract of partnership will

be liable from the date of his attaining majority, but in India he will be liable since the date of his admission to the partnership.

*Effect of fraud or misrepresentation:*—Just as any contract can be rescinded on the ground of fraud or misrepresentation, an agreement of partnership obtained by fraud or misrepresentation practised by the other partners can be rescinded, and thereafter the partner entitled to rescind has got the following rights, without prejudice to other rights :—

1. to a lien on, or a right of retention of, the surplus assets of the firm (*i.e.*, the assets of the firm remaining after the debts of the firm have been paid), for any money paid by him for purchasing a share in the firm, and for any capital contributed by him.
2. to rank as a creditor of the firm for any payment made by him in discharging the debts of the firm.
3. to be indemnified, by the partner or other partners guilty of fraud or misrepresentation, against all the debts of the firm (Section 52).

### Kinds of Partners

1. *Partner by 'holding out', or by estoppel*—It has been noticed in the law of agency that there is what is called 'agency by estoppel.' A similar principle is laid down in the case of partners as follows :—

"Any one who by words spoken or written or by conduct represents himself, or knowingly permits himself to be represented, to be a partner in a firm, is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit." (Sec. 28 (1) ).

Such a partner is called "partner by holding out". It may be noted that using the old firm name after the death of a partner, whether or not that firm name contained the name of the deceased partner as a part of it, would not by itself make his legal representative or estate liable on the foot of this principle, for any act of the firm done after his death. Cases of partnership by holding out arise where a partner retires from a firm, and yet does not give public notice of that fact, and acquiesces in the conduct of the other partners in using his name as a partner in the letterheads, bills, etc. It should however be noted that a person cannot be made liable as a partner on the principle of

estoppel, for torts or civil wrongs committed on behalf of the firm, because such a liability does not arise on account of any credit being given to the firm. *Smith v. Bailey* (1891) 2 Q. B. 403.

It may be noted that the liability of a ex-partner to creditors who have no notice of his retirement, rests entirely upon the continuing authority of the other partners to bind the firm by their acts i.e., on the principle of estoppel. But liability based upon estoppel is different from liability of the actual partners and the creditor cannot rely on both.

In *Scarf v. Jardine* (1882) 6 A. C. 345 a firm consisted of partners A, B and C. C retired without notice to creditors and a new partner D joined the firm. In a suit by one such creditor for recovery of moneys advanced to the firm subsequent to the retirement of C, it was held that the creditor could make the ex-partner C and his co-partners A and B liable on the principle of estoppel; or make the partners A, B and D liable as they are the actual partners: but that A, B, C and D all of them together could not be made liable.

2. *Dormant or sleeping partner.*—The mere fact that a partner does not appear as such, and is not taking any active part in the business of the firm would not absolve him from liability, because he occupies the position of an undisclosed principal, and the moment he is discovered to be a partner, he can be made liable.

3. *Sub-partner.*—A sub-partnership comes into existence when one of the partners agrees to share the profits derived by him from the firm, with a stranger. That stranger is called a sub-partner. He is not a partner in the eye of law, and cannot demand accounts, or settlement of his share in the profits of the firm.

**Relation of partners to each other—Rights and duties of partners**—Partnership being the result of an agreement between the partners, their mutual rights and duties are governed by the same. Such contract may be express, or implied, and it may be varied with the consent of all the partners, which may be express or may be implied from a course of a dealing (Section 11). As an agreement of partnership need not be in writing it sometimes happens that the terms of partnership are neither exhaustive, nor definite, as they are not reduced to writing. In order to avoid the difficulty arising in such cases the Act has laid down certain rights and duties between partners, which will be given effect to in the absence of a contract to the contrary. We shall take up the duties of a partner first.

### Duties of a Partner

1. To attend diligently to his duties in the conduct of the business, without any remuneration (Section 13 (a) ).
2. To carry on the business of the firm to the greatest common advantage.
3. To observe the utmost good faith in all dealings between him and the other partners, as partnership is a contract *uberrimae fidei*. *Green v. Howell* (1910) 1 Ch. 495.
4. To render true accounts.
5. To furnish full information of all things affecting the firm to any partner or his legal representative (Section 9).
6. To account for any profit, including secret profits, derived by him from any transaction of the firm, or from the use of the property, or business connection of the firm [Section 16 (a) ]. This obligation to account for secret profits applies to transactions by any surviving partner, or representatives of a deceased partner undertaken after the firm is dissolved on account of the death of a partner, and before its affairs have been completely wound up (Sec. 50).
7. A partner is bound by any agreement between himself and other partners, to the effect that no partner shall carry on any business other than that of the firm while he is a partner, even though it is an agreement in restraint of trade, hit by Sec. 27 Contract Act. (Section 11 (2) ).
8. If a partner carries on any business of the same nature as, and competing with that of the firm, he shall be bound to account for, and pay to the firm all profits made by him in that business (Sec. 16 (b) ).
9. After a firm is dissolved, a partner may restrain every other partner from carrying on a similar business in the firm name, or from using any property of the firm for his benefit, until the affairs are completely wound up (Section 53).
10. Since the relation between the partners is one of mutual trust and confidence, a partner cannot without the consent of his co-partners assign his share in the firm to a third party, and force him on the other partners. Where such an assignment is made it will be a good ground for dissolution. (Section 44) (e). During the continuance of the firm, an assignee from a partner whether

he obtained rights absolutely, or by way of charge or mortgage on the partner's share, is not entitled to interfere in the conduct of the business, or to require accounts, or to inspect the books of the firm, but is only entitled to receive the share of profits of the transferring partners, and the accounts accepted by all the partners will be binding upon him (Section 29 (i) ). If the firm is dissolved, or the transferring partner ceased to be a partner, the transferee is entitled to the share of the assets of the transferring partner and for ascertaining that share to an account as from the date of the dissolution (Section 29 (2) ).

11. To contribute equally to the losses sustained by the firm.

12. To exercise powers that are actually conferred upon him by the terms of the partnership agreement, and where he exceeds such authority to compensate the other partners for any loss resulting therefrom.

13. To indemnify the firm for any loss caused to it by his wilful neglect in the conduct of the business of the firm (Sec. 13).

14. To indemnify the firm for any loss caused to it by his fraud in the conduct of the business of the firm.

### Rights of a Partner

A partner has the following rights :

1. Every partner is a joint owner of the property of the firm which " includes all property and rights and interests in property originally brought into the stock of the firm, or acquired by purchase or otherwise, by or for the firm, or for the purposes and in the course of the business of the firm, and includes also the goodwill of the business." (Sec. 14).

2. Every partner is entitled to share equally in the profits earned. (Section 13 (b) ).

3. Every partner has a right to take part in the conduct of business. (Section 12 (a) ).

4. In an emergency every partner can do all such acts for the purpose of protecting the firm from loss as are reasonably necessary.

5. Every partner has a right to have access to and inspect and copy any of the books of the firm. (Section 12 (d) ).

6. Every partner shall have the right to express his opinion on any matter, but in case of difference of opinion regarding

ordinary matters of the business he is bound by the view of the majority. But no change may be made in the nature of the business without the consent of all the partners. (Section 12 (c) ).

7. Where a partner is entitled to claim interest on the capital subscribed by him, such interest shall be payable only out of profits. (Section 13 (c) ).

8. Every partner is entitled to interest at 6% per annum on any amount advanced by him beyond the amount of capital which he has agreed to subscribe. (Section 13 (d) ).

9. Every partner is to be entitled to be indemnified by the firm in respect of liabilities incurred by him in the ordinary course of the business, and in emergency. (Section 13 (e) ).

10. Every partner is entitled to remain in the firm, unless a power to expel is conferred upon the partners, and it has been exercised *bona fide* by a majority of the partners (Section 33 (i) ).

11. A new partner cannot be introduced into the firm without the consent of all the existing partners. (Section 31 (1) ).

12. A partner does not become liable for any of the liabilities of the firm contracted before he joined the firm. (Sec. 31 (2) ).

13. A partner may retire (a) with the consent of all the other partners, (b) in accordance with an express agreement between the partners, or (c) where the partnership is at will, by giving notice in writing to all the other partners of his intention to retire. (Section 32 (i) ).

14. Unless restrained by a reasonable agreement, an outgoing partner can carry on a business competing with that of the firm, and advertise such business. But he should not do the following :—(a) use the firm name. (b) represent himself as carrying on the business of the firm. (c) solicit the custom of persons who were dealing with the firm before he ceased to be a partner. (Sec. 36 (i) ).

15. A retired partner or the representative of a deceased partner is entitled, in case the share of such partner in the property of the firm has not been ascertained, and delivered by the other partners, to claim profits that may be attributable to the use of such share, or interest at 6% on that share from the date on which it ought to have been paid up, to the date of payment whichever is higher. This rule however does not apply if the



other partners are entitled to purchase the share of a deceased or out-going partner according to an agreement between them and that option was duly exercised complying with its terms in all material respects. (Sec. 37).

*Rights and duties of partners after change in the firm* :—We have already noticed that even after the death or retirement of a partner, the business of the firm may be carried on by the remaining partners, or sometimes with the addition of a new partner. Similarly a firm may carry on business after the duration for which it was formed has expired, or the adventures or undertakings for which it was formed have been carried out; but the partners who continue the business will, in the eye of law be a new and different firm, which is called a '*reconstituted firm*'. The mutual rights and obligations of the partners in the reconstituted firm are laid down in Sections 17 as follows :—

“ Subject to contract between the partners :—

- (a) where a change occurs in the constitution of a firm, the mutual rights and duties of the partners in the reconstituted firm remain the same as they were immediately before the change, as far as may be ;
- (b) where a firm constituted for a fixed term continues to carry on business after expiry of that term, the mutual rights and duties of the partners remain the same as they were before the expiry, so far as they may be consistent with the incidents of partnership at will ; and
- (c) where a firm constituted to carry out one or more adventures or undertakings, carries out other adventures or undertakings, the mutual rights and duties of the partners in respect of other adventures or undertakings are the same as those in respect of the original adventures or undertakings.”

### Relations of partners to third parties

*Liability of partners* :—(i) Every partner is the agent of the firm for the purposes of the business of the firm (Section 18). Subject to provisions of Sec. 22, the act of a partner which is done to carry on, in the usual way the business of the kind carried on by the firm binds the firm. This authority of a partner to bind the firm is called “ *implied authority*” Sec. 19(1). It is also called *ostensible* or *apparent authority*. According to Section 22 it is necessary, in order to bind a firm, that an act or instrument, done, or executed by a partner or other person on behalf of the firm shall be done or executed in the firm name, or

in any other manner expressing or implying an intention to bind the firm.

Every partner is liable jointly with all the other partners and also severally, for all the acts of the firm done while he is a partner (Sec. 25). An *act of a firm* is defined by Sec. 2 (a) as "any act or omission by all the partners, or by any partner or agent of the firm, which gives rise to a right enforceable by or against firm." The rule that the liability of a partner for acts of the firm is joint and several is consistent with Sec. 43 of the Indian Contract Act, to the effect that in the absence of an express agreement to the contrary, all joint promises create joint and several obligations. In England however the liability of a partner for the debts and obligations of the firm is only joint, though after the death of a partner his estate can be made severally liable (though not in competition with his separate creditors) for debts of the firm, contracted while he was a partner, and remaining unsatisfied. Even in England every partner will be jointly as well as severally liable for : (i) any wrongs committed by a partner in the ordinary course of business of the firm, or with the authority of the co-partners, which cause loss or injury to third persons, and (ii) misapplication of money or property by a partner received by him while acting within the scope of his authority, or while they are in the custody of the firm in the course of its business. If any loss or injury results to a third party from a wrongful act or omission of a partner, acting in the ordinary course of the business of the firm, or with the authority of the partners, the firm will be liable to the third party to the same extent as that partner. (Section 26).

In *Hamlyn v. Houston & Co.* (1903) 1 K. B. 81 one of two partners of a firm induced the clerk of the plaintiff by bribes to disclose certain confidential information, concerning plaintiff's business, which was competing with the business of the firm. The plaintiff consequently suffered damage. It was held that the firm (i.e., both the partners therein) were liable ; that obtaining the confidential information being within the scope of the partners' authority, the other partner could not escape liability simply because the acts committed to procure it were fraudulent.

Thus the liability of a partner equally extends to torts committed on behalf of the firm, even if they amount to crimes.

(ii) Where a partner's ostensible authority is curtailed by means of an agreement between himself and his co-partners, then

on the principle analogous to that of an agent, an act of the partner within the scope of the ostensible authority, but beyond his actual authority, would be binding upon the firm, unless the third party is aware of the curtailment of the ostensible authority.

(iii) Section 19 (2) enumerates a number of acts as not falling within the ostensible or implied authority of a partner. Thus unless there is any usage or custom of trade to the contrary, a partner cannot do any of the following acts, so as to bind the firm :

- (a) submit a dispute relating to the business of the firm to arbitration,
- (b) open a banking account on behalf of the firm in his own name,
- (c) compromise or relinquish any claim or portion of a claim by a firm,
- (d) withdraw a suit or proceeding filed on behalf of the firm,
- (e) admit any liability in a suit or proceeding against the firm,
- (f) acquire immovable property on behalf of the firm,
- (g) transfer immovable property belonging to the firm, or
- (h) enter into a partnership on behalf of the firm.

(iv) Notice to a partner who habitually acts in the business of the firm of any matter relating to the affairs of the firm operates as notice to the firm, except in the case of fraud on the firm committed by, or with the consent of that partner (Section 24).

(v) An admission or representation made by a partner concerning the affairs of the firm is evidence against the firm, if it is made in the ordinary course of its business (Section 23).

### Incoming and Outgoing partners

We have already noticed that no person can be introduced as a partner into a firm without the consent of all the existing partners. A person introduced as a partner into a firm does not thereby become liable for any act of the firm, done before he became a partner (Sec. 31). A partner may retire (a) with the consent of all the other partners, (b) in accordance with an express agreement by the partners, or (c) where the partnership is at will by giving notice

in writing to all the other partners of his intention to retire. A retiring partner may be discharged from liability by (i) Novation and (ii) Public Notice (*infra*) (Sec. 32). A partner cannot be expelled even by a majority of his co-partners unless such a power is conferred by contract between the partners, and it is exercised in good faith. (Sec. 33). Where a partner is adjudicated an insolvent he ceases to be a partner on the date on which the order of adjudication is made, whether or not the firm is thereby dissolved. Where under a contract between the partners the firm is not dissolved by the adjudication of partner as an insolvent, the estate of the insolvent partner is not liable for any act of the insolvent done after the date on which order of adjudication is made. (Sec. 34). Where under a contract between the partners the firm is not dissolved by the death of a partner, the estate of a deceased partner is not liable for any act of the firm done after his death. (Sec. 35). An outgoing partner can carry on a business competing with the firm subject to certain conditions (*supra*) (Sec. 36). A retiring partner and a representative of a deceased partner are entitled to have subsequent profits if their accounts are not finally settled (*supra*) (Sec. 37). A continuing guarantee given to a firm or to a third party, in respect of the transactions of the firm is, in the absence of an agreement to the contrary, revoked as to future transactions. (Sec. 38).

*Termination of a partner's liability* :—A partner's liability comes to an end in the following ways :—

(1) *Novation* :—A retiring partner can get rid of his liability for acts done during the time he was a partner, by means of a tripartite agreement called novation, between himself and the third party creditors, and the partners continuing the business after his retirement, called partners of the reconstituted firm. Section 32 (2) dealing with this point lays down as follows :—

“ A retiring partner may be discharged from any liability to any third party for acts of the firm done before his retirement by an agreement made by him with such third party and the partners of the reconstituted firm, and such agreement may be implied by a course of dealing between such third party and the reconstituted firm after he had knowledge of the retirement.”

(ii) *Public Notice* :—Section 45 imposes an obligation on the part of every partner to give public notice of the dissolution of the firm, and until it is given, every one of them is made liable to third parties for acts which would bind them, if the firm were not

dissolved. But the estate of a deceased partner, or of an insolvent or a retired partner, who was not known to the person dealing with the firm to be a partner, cannot be made liable for acts done after the date on which they ceased to be partners, on the ground that such public notice was not given. Notice under this section can be given by any partner.

*Continuing authority of partners for purposes of winding up :—*

Even after a firm is dissolved several acts will have to be done on its behalf, before its affairs are completely wound up. It is necessary that with respect to such acts the liability of partners should continue as before. With this object, Section 47 enacts thus :

“ After the dissolution of the firm the authority of each partner to bind the firm, and the other mutual rights and obligations of the partners continue notwithstanding the dissolution, so far as may be necessary to wind up the affairs of the firm and to complete transactions begun but unfinished at the time of the dissolution, but not otherwise :

Provided that the firm is in no case bound by the acts of the partner who has been adjudicated insolvent but this proviso does not affect the liability of any person who has after the adjudication represented himself or knowingly permitted himself to be represented as a partner of the insolvent.”

### Dissolution of a Firm

The Act draws a distinction between *dissolution of partnership* and *dissolution of firm*. Sec. 39 lays down that dissolution of partnership between all the partners of a firm is called the ‘dissolution of the firm’. Therefore a firm does not get dissolved unless all and every one of the members of the firm cease to carry on its business in partnership. Thus every dissolution of firm means dissolution of partnership, but not vice versa, unless the firm consists only of two partners. A firm may be dissolved with the consent of all the partners, or in accordance with a contract between the partners (Sec. 40).

*Compulsory Dissolution of the firm :—*A firm is compulsorily dissolved in the following cases :—

- (i) By the adjudication of all the partners or all the partners but one as insolvent, or
- (ii) By the happening of any event which makes it illegal for the business to be carried on, or for the partners to carry on in partnership. But if the partnership relates to more than one adventure, the illegality of one or more of them does not prevent the lawful adventures from being carried on by the firm (Section 41).

*Dissolution on the happening of certain contingencies:—* In the absence of a contract to the contrary, a firm is dissolved on the happening of the following events :—

- (a) if constituted for a fixed term by the expiry of that term ;
- (b) if constituted to carry out one or more adventures or undertakings, by the completion thereof.
- (c) by the death of a partner ;
- (d) by the adjudication of a partner as an insolvent, (Section 42).

*Dissolution of partnership at will :—* Where partners while entering into an agreement of partnership make no provision for the duration of their partnership, or for the determination of their partnership, the partnership is called "partnership at will" (Section 7). In the case of a partnership at will the firm may be dissolved by any partner giving notice in writing to all the other partners, of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution, and if no date is mentioned from the date of communication of the notice (Section 43).

A partnership at will is different from a partnership terminable by mutual arrangement only. In the latter kind of partnership it can be dissolved only by mutual consent and mere notice from a partner will not dissolve the partnership and even the Court cannot dissolve such partnership unless the circumstances are such as to warrant dissolution under Section 44 of the Act.

*Dissolution through Court :—* If a partnership is not a partnership at will, nor one for a fixed period, nor one which has provided for any mode of dissolution, and the business of the firm cannot be carried on with profit and all the partners do not agree for dissolution what is to happen? It is undisputed that in such cases Courts should be given the power to dissolve the firm. Section 44 has grouped together all cases in which a Court can dissolve a firm and it runs as follows :—

" At the suit of a partner, the Court may dissolve a firm on any of the following grounds, namely :—

- (a) that a partner has become of unsound mind, in which case the suit may be brought as well by the next friend of the partner who has become of unsound mind as by any other partner ;
- (b) that a partner, other than the partner suing, has become in any way permanently incapable of performing his duties as partner ;

- (c) that a partner, other than the partner suing, is guilty of conduct which is likely to affect prejudicially the carrying on of the business, regard being had to the nature of the business ;
- (d) that a partner other than the partner suing, wilfully or persistently commits breach of agreement relating to the management of the affairs of the firm or the conduct of its business, or otherwise so conducts himself in matters relating to the business that it is not reasonably practicable for the other partners to carry on the business in partnership with him ;
- (e) that a partner, other than the partner suing, has in any way transferred the whole of his interest in the firm to a third party, or has allowed his share to be charged under the provisions of Rule 9 of Order 21 of the first Schedule to the Code of Civil Procedure 1908, or has allowed it to be sold for the recovery of arrears of land revenue, or of any dues recoverable as arrears of land revenue by the partner ;
- (f) that the business of the firm cannot be carried on save at a loss or
- (g) on any other ground which renders it just and equitable that the firm should be dissolved."

*Winding up of the firm:*—Though the dissolution of a firm, operates as disruption of the legal relationship subsisting between the partners, that does not by itself bring about the final settlement of the affairs of the firm. Because the firm may have to realise moneys from others, or may have to discharge debts due to others, or it may have to discharge its liabilities by way of performance of certain contracts. Further it may have to dispose of profitably the stock in trade and other properties of the firm, and after satisfying all the creditors, distribute the surplus assets between the partners. All these matters cannot be settled by a mere notice of a partner, in the case of partnership at will, or a resolution of the partners, or an order of the Court dissolving the firm. They have to be carried out by means of separate proceedings known as '*winding up.*' During the winding up "every partner or his representative is entitled as against all the other partners or their representatives to have the property of the firm applied in payment of the debts and liabilities of the firm and to have the surplus distributed among the partners or their representatives according to their rights" (Section 46),

*Partner's lien:*—This right of a partner to have the property of the partnership applied in payment of the firm's debts, and to have the amounts due from the other partners deducted

what would otherwise be payable to them towards their shares so as to secure a proper division of the surplus assets, is called "*partner's lien*."

*Settlement of Partner's Accounts* :—The right of a partner to represent other partners, even after dissolution of the firm, by carrying on the business of the firm, as far as it is necessary for a proper winding up, is recognised in Section 47 (*supra*). The mode of settling the accounts of the dissolved firm is to be found in Section 48 which runs as follows :—

"In settling the accounts of the firm after dissolution, the following rules shall, subject to agreement by the partners, be observed :—

- (a) Losses including deficiencies of capital, shall be paid first out of profits, next out of capital and lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.
- (b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order :
  - (i) in paying the debts of the firm to third parties;
  - (ii) in paying to each partner rateably what is due to him from the firm for advances as distinguished from capital;
  - (iii) in paying to each partner rateably what is due to him on account of capital : and
  - (iv) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits."

This section is almost a copy of Section 44 of the English Act and is very important, as it lays down in very clear terms the manner of making up losses, and distribution of the assets of the firm.

*Payment of firm debts and separate debts* :—The next thing that has to be considered is the competing claims of the creditors of the individual partners, as against the claims of the creditors of the firm. This question is of paramount importance as the creditors of an individual partner would try to proceed against the assets of the firm if they are more easily available or the assets of that individual partner are not sufficient to satisfy all his creditors, and the creditors of the firm would similarly try to proceed against property of the individual partners if it is advantageous to do so. To permit such a thing would be to defeat the rights of one kind of creditors or the other as the case may be. With a view to protect the rights of each class of creditors, the well-settled rule in bankruptcy dealing with the distribution of



assets of joint estate, and separate estate of bankrupts has been applied by Section 49, and it reads as follows :—

“Where there are joint debts due from the firm and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm and if there is any surplus, then the share of each partner shall be applied in payment of his separate debts or paid to him. The separate property of any partner shall be applied first in the payment of the separate debts, and the surplus (if any) in the payment of the debts of the firm.”

In the case of a partner's insolvency also the rule is the same, and is contained in Section 70 (4) of the Presidency Towns Insolvency Act, and Section 61 (4) of the Provincial Insolvency Act.

In *Lala Nanda Kishore v. Azmat Ullah, Official Receiver Delhi and another.* A.I.R., 1938 P. C. 277, where one of the partners in a firm, consisting of two partners, paid more than his share of contribution for the business, and it was stipulated that the other partner, and not the partnership, was to pay interest on such excess, it was held that the excess paid was to be treated as a loan to the other partner individually, and not as a loan to the firm. It was also held that where a partner advanced money to the other partner for acquiring a share in the partnership, the former would not get a lien on the latter's share in the partnership property, and that he could not be placed on a higher footing than the other creditors of that partner, on the latter's insolvency.

*Sale of Goodwill after dissolution* :—“In settling the accounts of a firm after dissolution, the goodwill shall, subject to contract between the partners be included in the assets and it may be sold either separately or along with other property of the firm.” (Sec. 55 (1)). The term ‘goodwill’ is a commercial rather than legal term, and in the words of Lord Macnaghten it is “a thing very easy to describe, very difficult to define.” It has been however described as the benefit arising from connection and reputation, which includes the probability of the old customers going to the new firm, which has acquired the business. The Act makes it clear that goodwill is a partnership asset.

*Rights of buyer and seller of goodwill* :—“Where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business, but subject to an agreement between him and the buyer, he may not (a) use the firm name, (b) represent himself as carrying on the business of the firm, or (c) solicit the custom of persons who were dealing with the firm before its dissolution.” (Sec. 55 (2)). *Trego v. Hunt*, (1896) A. C. 7,

*Restraint of Trade*:—It has already been observed, while dealing with Section 27 of the Contract Act, that Sections 11 (2), 36 (2) 54 and 55 Clause (3) of the Partnership Act provide that agreements, imposing a reasonable restraint on partners from carrying on trade, in specified local limits if subject to certain conditions, are recognised as valid.

**Registration of Firms** :—The chapter dealing with registration of firms is a welcome addition to the Indian law. The Act deals with the registration of firms, and incidental matters, with a view to place the information regarding the affairs of firms within the easy reach of the public, who want to deal with them. Section 57 authorises the Local Governments to appoint Registrars of firms, and Sections 59 to 67 deal with the manner of registration, and recording of alterations in the firm name, place of business etc., and changes in the names and addresses of partners, and rectification of mistakes, grant of copies etc. But two sections which deserve careful notice are Sections 58 and 69. Section 58 lays down that a firm may be registered at any time by sending by post, or delivery in person, to the Registrar of Firms, a statement containing the following particulars, signed by all the partners, or by their agents, specially authorised in that behalf, and duly verified. The following are the particulars to be noted in the statement :—(a) the firm name, (b) the place or principal place of business of the firm, (c) the names of any other places where the firm carries on business, (d) the date when each partner joined the firm, (e) the names and addresses of the partners, and (f) the duration of the firm.

According to Sections 60 to 62 the alterations in the names of partners, name of the business etc., may also be noted in the register of the Registrar. Section 58 as well as Sections 60 to 62 appear to be enabling provisions with no penalty for non-compliance, but Section 69 has imposed sufficient punishment by refusing the assistance of Courts to firms which are not registered, and to partners of such firms. It was perhaps thought by the Legislature that no greater punishment was needed to induce firms to get themselves registered. Though the Act came into force on 1st October, 1932 the operation of Section 69 had been postponed till 1st October, 1933, to enable all existing firms to get themselves registered in that interval.

**Effect of non-registration :—**Section 69 lays down the consequences of non-registration of a firm as follows :—

“(1) No suit to enforce a right arising from a contract or conferred by this Act shall be instituted in any Court by or on behalf of any person suing as a partner in a firm against a firm or any person alleged to be or to have been a partner in the firm unless the firm is registered and the person suing is or has been shown in the Register of Firms as a partner in the firm.

(2) No suit to enforce a right arising from a contract shall be instituted in any Court by or on behalf of a firm against any third party unless the firm is registered and the persons suing are or have been shown in the Register of Firms as partners in the firm.

(3) The provisions of sub-sections (1) and (2) shall apply also to a claim of set off or other proceeding to enforce a right arising from a contract, but shall not affect—

(a) the enforcement of any right to sue for the dissolution of a firm or for accounts of a dissolved firm or any right or power to realise the property of a dissolved firm, or

(b) the powers of an official assignee or receiver of Court under the Presidency Towns Insolvency Act 1909, or the Provincial Insolvency Act 1920, to realise the property of an insolvent partner.

(4) This section shall not apply—

(a) to firms or to partners in firms which have no place of business in British India, or whose places of business in British India, are situated in areas to which by notification under Section 55 this Chapter does not apply, or

(b) to any suit or claim of set-off not exceeding one hundred Rupees in value which in the Presidency towns is not of a kind specified in section 19 of the Presidency Small Cause Courts Act 1882, or outside the Presidency towns is not of a kind specified in the Second schedule to the Provincial Small Cause Courts Act 1887, or to any proceeding in execution or other proceeding incidental to or arising from any such suit or claim.”

There was a sharp difference of opinion between the several High Courts, and even as among the learned Judges of the Madras High Court, on the question, whether a firm which was not registered on the date of the presentation of a plaint, but was registered subsequently, could be permitted to proceed with that suit.

In *Ponnuchammi Goundar v. Muthuswami Goundar* I.L.R. 1942 Mad. 355 a bench of two Judges of the Madras High Court reviewed all the decisions on the point, and settled the law so far as that High Court is concerned. It was held that section 69 of the Act is mandatory and that the registration of the firm is a condition precedent to its right to institute the suit. If a firm was not registered at the time of the presentation of the plaint, but was registered only subsequently, it was held that the only course open to the Court is to dismiss the suit,

Besides having the assistance of the Court, another advantage of registration is that any statement, intimation or notice recorded or noted in the Register of Firms is conclusive proof of the facts stated therein, and a certified copy of the entry is sufficient proof of the fact of registration of the firm, and also the contents therein (Section 68).

*Public Notice.*—A public notice, whenever required under this Act, is given as follows :—

- “(a) where it relates to the retirement or expulsion of a partner from a registered firm, or to the dissolution of a registered firm, or to the election to become or not to become a partner in a registered firm by a person attaining majority who was admitted as a minor to the benefits of partnership, by notice to the Registrar of Firms under Section 63, and by publication in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business, and
  - (b) in any other case by publication in the local official Gazette and in at least one vernacular newspaper circulating in the district where the firm to which it relates has its place or principal place of business” (Section 72).
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## CHAPTER XX

### NEGOTIABLE INSTRUMENTS

If there is one thing to which the speedy settlement of mutual accounts of businessmen, and safe transport of moneys can be attributed, it is the negotiable instrument. This credit machine is the pivot about which the wheel of commerce has been rotating, and is bound to rotate, unless by the introduction of some socialistic principle, commercial credit ceases to play the important part which it is playing to-day. The service it is rendering to civilized society in general, and the mercantile community in particular, is so immense that the law relating to it deserves very careful study.

*What is a Negotiable Instrument* :—It was defined by Judge Wallace as one “ the property in which is acquired by anyone who takes it *bona fide* and for value notwithstanding any defect of title in the person from whom he took it; from which it follows that an instrument cannot be negotiable unless it is such and in such a state that a true owner could transfer the contract or engagement contained therein by simple delivery of the instrument.” For example a promissory note, a bill of exchange, and a cheque are all negotiable instruments.

To put it more simply a negotiable instrument is a chose-in-action, with the feature of negotiability attached to it. It is this feature of negotiability that distinguishes ordinary choses-in-action from negotiable instruments. It is a matter of familiar knowledge that an assignee or a transferee of a chose-in-action (like a money bond) cannot claim higher or better rights than his transferor. Because the rule, relating to transfer of ownership in goods as already noted, is ‘*Nemo dat quod non habet*’—no one can convey a better title than what he has. Thus if a person entitled to a chose-in-action has got a defective title on account of some vitiating element *e.g.*, coercion, fraud, or undue influence etc., the assignee, or the transferee from him will also get a title subject to those defects. But to this rule a negotiable instrument is an exception. A negotiable instrument in the hands of a *bona fide* holder for value, would entitle him to claim

all the rights appearing on the face of the instrument, without being affected in the least by the defective title of his transferor. Further in order to transfer ownership in a negotiable instrument no formalities are necessary. It may be done even by mere delivery of the instrument. These two characteristics constitute negotiability, and a chose-in-action having these characteristics is called a Negotiable Instrument.

The essential features of a negotiable instrument may now be noted :—

1. It is a contract to pay money.
2. The property in it passes from hand to hand by mere delivery, or by endorsement and delivery, without any formalities e.g. writing, stamp etc.
3. A *bona fide* transferee for value is not affected by any defect in title of his transferor, or any of the previous holders of the instrument.
4. The transferee of a negotiable instrument can sue in his own name.
5. It can be transferred *ad infinitum*, till it is at maturity.
6. It is as good as cash, because cash can be obtained any moment (even before the time fixed for payment in the instrument), by paying a small commission.
7. It is capable of easy proof, and it has got special rules of evidence, (e.g., a presumption that consideration has been paid under it; that the amounts not endorsed have not been paid; that it is executed on the day on which it purports to be executed etc.)
8. It enables the holder of the instrument to expect prompt payment, because a dishonour for non-payment of a negotiable instrument means the ruin of the credit of all persons who are parties to the instrument, either as executant or as endorsees.

There are several other negotiable instruments, besides promissory notes, bills of exchange, and cheques, and new types of negotiable instruments may be recognised by Courts, if by mercantile practice, though of recent origin, they are treated as negotiable instruments. *Bechuanland Exploration Coy. v. London Trading Ltd.* (1898) 2 Q.B. 658. (Held that debentures payable to

bearer have by modern mercantile usage, become negotiable instruments). The following are some of the instruments which have been declared to be negotiable according to English Law:—

1. Exchequer or Treasury bills; 2. Bank notes; 3. Scripts of Foreign Government, where they are negotiable according to the law of the country of issue; 4. Dividend warrants; 5. Share warrants; 6. Debentures payable to bearer.

*History of the Law.*—The law in India relating to negotiable instruments is contained in the Negotiable Instruments Act XXVI of 1881, which repealed and replaced the prior enactments. It deals only with Promissory Notes, Bills of Exchange and Cheques, but it also applies to native Bills of Exchange, called Hundis, unless a special local usage is set up and proved. The only time-honoured negotiable instrument known to the Indian bankers is the 'Hundi', a derivative of the Sanskrit word 'Hund,' meaning 'to collect', and the law relating to these instruments was fairly understood, and applied by the Indian Courts even prior to the passing of the present Act. The law relating to cheques and promissory notes however is an importation from the West into our country. The law applicable to bills of exchange, cheques, and promissory notes had become fairly settled in England only by the middle of the 17th century, and it was finally codified as the Bills of Exchange Act 1882, which repealed the earlier Acts. The said Act is based mainly on the Law Merchant, and the Indian Act is almost a copy of the English Statute. Except where the contrary is expressed, references in this chapter are to the Negotiable Instruments Act, 1881.

*Preamble.*—The preamble makes it clear that the Act defines and amends the law relating to Promissory Notes, Bills of Exchange and Cheques, the three types of negotiable instruments which are most popular. Further Sec. 13 (1) defines a negotiable instrument to mean a promissory note, bill of exchange or cheque, which is payable either to order or to bearer. The Act applies to the whole of British India, but it does not affect any local usages relating to instruments in any oriental language. Thus hundis, (which are bills of exchange in vernacular language) are governed by the special customs relating to them, and not by the provisions of the Act. Where no such custom is established, the Act will equally apply to hundis and

other native instruments. Even in the case of native instruments which have special customs, it is open to the parties to stipulate by express words that their relations shall only be determined by the Act, and not by the said customs.

The Act does not affect Sec. 25 of the Indian Paper Currency Act 1882, which has been repealed and replaced by S. 31 of Reserve Bank of India Act 1934. That section forbids drawing, accepting, making or issuing bills of exchange, hundis, promissory notes or engagements for the payment of money which are *payable to bearer on demand*; or borrow, owe or take up any sums of money on the *bills, hundis or notes payable to bearer on demand of such person*; and the proviso to it excludes its application to cheques. Further Sec. 62 of the Reserve Bank of India Act makes the issuing of such prohibited instruments an offence. The object of these sections is to protect the Government's monopoly of issuing paper currency i.e., notes payable to bearer on demand. That is why in addition to the preamble expressly saving the operation of Sec. 25 of the Paper Currency Act, Sec. 4 of the Negotiable Instruments Act clearly excludes a currency note from the definition of a promissory note. It should however be noted that it is only the making, drawing, or accepting of an instrument which is payable to bearer, and on demand, that is prohibited, but not endorsing. Therefore an instrument originally drawn payable on demand to a certain individual, can be endorsed in blank, i.e., made payable to the bearer. Further it is only the contract as contained in the instrument, that is forbidden and cannot be enforced. Therefore a suit based upon the original consideration is not barred. The combined effect of S. 31 of the Reserve Bank of India Act, and the Negotiable Instruments Act is therefore as follows :

1. A bill or promissory note payable to a particular person or his order, i.e., not payable to bearer, can be drawn or made payable on demand. Afterwards it can be made payable to bearer by means of an indorsement.
2. A bill or note can be drawn or made payable to bearer provided it is made payable after a certain date or event, (i.e., not on demand).
3. A cheque which is always payable on demand, can be drawn payable to bearer.



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1. A bill or promissory note payable to a particular person or his order, i.e., not payable to bearer, can be drawn or made payable on demand. Afterwards it can be made payable to bearer by means of an indorsement.
2. A bill or note can be drawn or made payable to bearer provided it is made payable after a certain date or event, (i.e., not on demand).
3. A cheque which is always payable on demand, can be drawn payable to bearer.

4. The foregoing rules apply only to private individuals and not to the Government of India, which can draw bills or make notes payable to bearer on demand, and whose rights are hereby secured.

### Definitions

*Banker.*—It is defined in Sec. 3 as follows :—

“Banker includes also persons or a corporation or a company acting as bankers.” Thus an individual as well as a corporation are both called bankers. A banker, though not defined in the Act, is one, who in the ordinary course of business, receives money, which he repays by honouring the cheques of the persons from whom and on whose account he receives it. He must be one who traffics in money, receives and remits money, negotiates bills of exchange with a view to make profit by such business. A Government treasury on which an order for payment may be made, is therefore not a banker, because its object is not to make profit.

*Notary public* is defined by Section 3 thus :—

“Notary public includes also any person appointed by the Central Government to perform the functions of a Notary public under this Act.” The functions of a Notary public are noting, and protesting bills, and sending notices of dishonour etc. See *infra*.

### Of Notes, Bills and Cheques

*Promissory note.*—Section 4 defines a promissory note thus:—

“A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.”

A typical form of a promissory note is as follows :—

Waltair,

15th May, 1946.

On demand I promise to pay Mr. Narayana Rao or order Rs. 500 (Rupees Five Hundred only) with interest at 6% per annum for value received.

Stamp.

(Sd.) RAMA RAO.

The essentials of a valid promissory note are :—

1. It must be in writing. The writing may be in ink or in pencil or even in print.

2. There must be an unconditional promise to pay. The essence of a promissory note is the unconditional undertaking of the executant or the maker. Therefore a mere acknowledgment of a debt or a promise to pay subject to a condition, or depending upon an event, which may or may not happen, does not amount to a promissory note. Thus an I. O. U. which is an abbreviation for 'I owe you' is nothing but an acknowledgment of indebtedness of the maker, and is not a promissory note. A promise to pay after a certain time is however an unconditional promise (Sec. 5).

In the recent case of *Mahomed Akbar Khan v. Attar Singh and others*, (1936) 17 Lahore 557 (P.C.) a document alleged to be a promissory note contained the following terms:—This one receipt is hereby executed by H and A residents of Hote for Rs. 43,900 half of which amount comes to Rs. 21,950 received from the firm of L, for and on behalf of M of Hote. This amount to be payable after two years. Interest at the rate of Rs. 5-4-0 per cent per year to be charged. Dated 1st April 1917. (Stamp has been duly fixed.) (Sd.) H. (Sd.) A.

The document was not drawn on a paper with an impressed stamp, and a stamp which was sufficient if the document was a receipt was affixed. It was held by the Privy Council that the document was a plain receipt for money containing the terms on which it was to be repaid, and that there being no undertaking to pay but an undertaking which has to be inferred from the words used it was not a promissory note.

3. It must be signed by the maker. If the executant is illiterate he may put his thumb mark, or any other mark indicating his intention to sign. The signature may be in ink or pencil or print or even by a stamp.

4. The executant or the maker of the note must be certain. The note must show on its face, or by a reasonable construction of it, the person who is liable as a maker. This rule is particularly important, because when an agent signs a promissory note on behalf of his principal, unless he signs as an agent, the principal will not be bound, but the agent alone will be personally liable. A promissory note may be made by two or more makers, and they will be jointly and severally liable under the same, but they cannot execute a promissory note so as to be liable in the alternative. Where, according to the body of a promissory note two persons had to jointly execute it, but only one of them executed it, it was held that it was not enforceable even against that person. *Amirtham Pillai v. Nanjah Goundan* 26 M. L. J. 257. On the other hand where the note began with "I promise to pay" but was

actually signed by two or more persons, it was held to be a joint and several note.

5. The promise must be to pay a sum of money which is certain. One of the essential features of a promissory note is that it must be a promise to pay money only, and that the amount must be certain. Therefore a promise to pay Rs. 1,000 and such other sums as may be due, would not make the promissory note valid, because the amount promised is uncertain. Similarly a promise to deliver paddy or other goods in addition to, or in the alternative for money would not constitute a promissory note.

6. The payee must be certain. The promisee or the person in whose favour the note is executed, called the payee, must be a person whose name appears in the promissory note. Where the payee is not described with any amount of certainty, the promissory note is not valid.

It may be noted that the particulars regarding the place, date of execution and the manner of the passing of consideration are not essential, and their absence would not render the promissory note invalid. But from a practical standpoint it is very desirable that those particulars should be given, because the date on the note would help the court in determining the question of limitation, while the place of execution would enable the court to determine whether it has local jurisdiction to try the suit or not.

A *Bank Note* and a *Currency Note*, though they may satisfy the requirements of a promissory note are specifically excluded from its definition, as they are treated as money itself, and not as securities for money. A *bank note* may be defined as "any bill, draft or note issued by any banker for the payment of money to the bearer on demand, and which will entitle the holder thereof to the payment of the sum of money without further endorsement". The issue of these bank notes by private persons is prohibited and its issue is governed by the Reserve Bank of India Act 1934.

It may be noted that a *Government Promissory Note* is a promissory note, and is governed by the Negotiable Instruments Act, but its endorsements and renewal, are governed by the Indian Securities Act X of 1920,

*Unstamped promissory note : -*

A promissory note should be properly stamped. Otherwise the note is invalid, and it cannot be used even as an acknowledgment

of the liability. If a promissory note is inadmissible in evidence for want of stamp, whether the payee can sue on the original consideration, is a question coming up for consideration rather frequently, but about which there is no unanimity of judicial opinion.

In the leading case *Sheik Akbar v. Sheik Khan*. 7 Cal. 256, which was followed by several High Courts it was held that where the cause of action for recovery of money is complete in itself, whether for goods sold or money lent or any other claim, and the debtor *thereafter* gives the promissory note or bill of exchange, and the creditor has not indorsed or parted with the bill or note, so as to make the debtor liable to some third person, the creditor may disregard the bill or note, if it is inadmissible in evidence for want of stamp etc., and sue on the original debt or consideration. Considerable difficulty was however experienced in cases where the loan and execution of the promissory note were contemporaneous or simultaneous, and there was no cause of action distinct from the note itself. There was a sharp difference of opinion between the several High Courts, whether in such cases the creditor could disregard the unstamped or insufficiently stamped note, and sue on the original consideration. The Madras High Court by a majority view (four out of five judges) has held that the answer to this question depends on the circumstances under which the instrument was executed. If the note was given in respect of an antecedent debt, or as collateral security, or by way of conditional payment, or if the note does not contain all the terms of the contract, the true nature of the contract could be proved. If however the note embodies all the terms of the contract, it was held that a suit on the debt or original consideration would not lie, as Sec. 91 of the Evidence Act and Sec. 35 of the Stamp Act barred the way. *Perumal Chettiar v. Kamakshi Ammal*. I.L.R. 1938 Mad. 933 (F.B.)

**Bill of Exchange :—Section 5 defines it thus :—**

“A Bill of Exchange is an instrument in writing containing an unconditional order signed by the maker directing a certain person to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

A promise or order to pay is not ‘conditional’ within the meaning of this section and section 4 by reason of the time for payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period after the occurrence of a specified event which, according to the ordinary expectations of mankind is certain to happen, although the time of its happening may be uncertain.

The sum payable may be certain within the meaning of this section and section 4 although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange, and although the instrument provides that, on default of payment of an instalment, the balance unpaid shall become due.

The person to whom it is clear that the direction is given, or that payment is to be made, may be a “certain person”, within the meaning of this

section and section 4 although he is misnamed or designated by description only."

It may be noted that a bill of exchange is also called a *draft*.

A typical form of a bill of exchange is as follows :—

Rs. 1,000.

Waltair,  
4th April, 1946.

On demand pay Narayana Rao or order, the sum of Rs. 1,000  
(Rupees One thousand) only for value received.

To

Moses Alfred,  
Mount Road,  
Madras.

[ Stamp, ]  
(Sd.) RAMA RAO,

This is an order bill payable on demand. If instead of the words 'on demand' words indicating the time when the bill should be paid are used *e.g.*, 'pay thirty days after date' it will be an order bill payable at a fixed time. In the later case the bill instead of being made payable to a particular individual, 'may be made payable to bearer by so expressing it.

The essentials of a Bill of Exchange are :—

- (i) It must be in writing ;
- (ii) There should be an unconditional order to pay ;
- (iii) There should be three parties to the instrument ; *e.g.*,  
(a) drawer ; (b) drawee ; (c) payee.

In the above form the maker of the bill (Ramarao) is called the *drawer*, the person who is ordered to pay (Moses Alfred) is called the *drawee*, and the person named in the instrument, to whom or to whose order the money is by the instrument directed to be paid. (Narayanarao) is called the *payee*. The payee, or if it is endorsed, the endorsee, is called the *holder* of the bill.

- (iv) The order must be to pay a certain sum of money.

The essentials as to writing, the unconditional nature of the order, and the order relating only to payment of money, are as already noted, to be found in the case of promissory notes, and the remarks made in that connection therefore equally apply to bills of exchange. Though there should be three parties in the case of a bill it may be noted that all the three need not be different entities. One person can play the role of two parties, the third party, however, being a different individual. For instance

the same person can be the drawer as well as the payee. Similarly the same person may be the drawee as well as the payee. In both these cases the instrument is a valid bill of exchange. However in a case where the drawer as well as the drawee are the same (*i.e.* if the order to pay is made by a person upon himself) and the instrument is negotiated, it is no doubt a valid negotiable instrument, but the holder of the instrument can at his option treat it either as a promissory note, or a bill of exchange, and it shall thence forward be treated accordingly. Similarly where the drawee is a fictitious person, or a person incapable of contracting, the holder can treat the instrument either as a promissory note, or as a bill of exchange. These instruments which may be construed either as promissory notes, or bills of exchange, are called *ambiguous instruments* (Sec. 17).

Bills are often drawn against goods and negotiated with the bill of lading or other document of title attached to it, until accepted by the drawee, thus furnishing the holder with a security in case acceptance should be refused by the drawee. On acceptance the document of title is retained by the acceptor, and the accepted bill is returned to the holder. Bills of this kind are said to be drawn D/A. *i.e.*, documents on acceptance.

*Effect of drawing a bill of exchange.*—The mere drawing of a bill does not create any privity of contract between the drawee and the payee. If the drawee accepts the bill, he is called the *acceptor* and he will be liable as a principal debtor. But if the drawee refuses to accept the bill, even while having the funds of the drawer with him, the only right of the holder of the instrument is to proceed against the drawer and the prior endorsers, but not against the drawee, because the drawee never accepted the bill, and a mere drawing of a bill by the drawer does not operate as an assignment of the debt to the payee.

*Bills-in-sets.*—Generally foreign bills are drawn in sets *i.e.*, they are drawn in parts, each part being numbered and containing a provision that it shall continue payable only so long as the others remain unpaid. All the parts together make one set, and the whole set constitutes only one bill, and the payment of one bill discharges the whole set. Acceptance should be made only of one of them, and if the drawee accepts more than one, he and



the endorsees will be liable as if they are separate bills. A holder in due course of the first part is entitled to all the other parts, and the money represented by the bill, as against the holders in due course of the other parts. (Secs. 132 and 133).

A typical form of a bill-in-set is as follows :—

£ 500.

Waltair,

1st April, 1946.

Six Months after sight of the first of this exchange (2nd and 3rd of the same tenor and date) being unpaid pay Narayanarao or order a sum of £s. 500 (Pounds Five Hundred) only for value received.

To

L. Cook, Esq.,  
London.

[Stamp]  
(Sd.) RAMA RAO.

### *Points of difference between a Promissory Note and a Bill of Exchange*

#### *Promissory Note.*

1. There are only two parties to it *e.g.*, the maker and the payee.
2. It contains an unconditional promise to pay.
3. The maker is liable absolutely as a principal debtor.
4. Presentment for payment is not necessary to render the maker liable, but necessary to make the indorser liable. If it is made payable at a particular place, it must be presented at that place to render even the maker liable.
5. Provisions relating to : (i) acceptance; (ii) acceptance supra protest (iii) bills-in-set, are not applicable to promissory notes.

#### *Bill of Exchange.*

1. There are three parties to it *e.g.*, the drawer, the drawee, and the payee.
2. It contains an unconditional order to the drawee to pay the amount to the payee.
3. Till the bill is accepted by the drawee, the drawer is liable as a principal debtor. But after acceptance the drawer becomes liable as a surety, and the acceptor becomes the principal debtor.
4. A bill must be presented for acceptance (where acceptance is necessary), as well as for payment, in order to make the drawer and endorsers liable.
5. They apply to bills of exchange.

### Hundis.

It has already been mentioned that trade was flourishing in India long prior to the passing of the Negotiable Instruments Act, and that the Indian merchants were having recourse to Hundis for the purpose of transmitting money from one place to another with perfect safety.

*Definition of a Hundi* :—A Hundi may be defined as a bill of exchange drawn in a vernacular language in accordance with the customs of native merchants in India. The drawer of a hundi is called Shroff or Nanavaty, corresponding to a banker. The payee is called "Rakhya Dhani." The following are some of the well-known types of hundis :—

1. *Shahajog Hundi* :—It is a hundi payable only to a 'Shah' or respectable holder, *e.g.*, a man of worth and substance known in the bazaar. It ought not to be paid by the drawee unless the Shah, by whom it is presented, has endorsed on it, though till it reaches the hands of the Shah, it can pass from hand to hand, without any endorsement. According to custom relating to these hundis the Shah who obtains payment is bound, in the event of the hundi proving to be forged or stolen, to repay the amount paid to him with interest, unless he produces the actual drawer, or the person who perpetrated the fraud.

2. *Jokhmi Hundi* :—This is a hundi which is drawn against goods shipped on a vessel named therein. The hundi is negotiated by the drawer to a person who purchases it for an amount less the commission, and who insures the goods against loss. He will recover the full value of the hundi from the consignee only on the safe arrival of the goods. If they do not reach the destination on account of loss or destruction the consignee need not pay the value of the hundi, nor need the consignor repay the money—received by him, as the goods are insured.

3. *Namjog Hundi* :—It is a hundi payable only to the party named in the bill or his order. If the party named in the bill is sufficiently described, it is only payable to that person, and it cannot be endorsed. But if a full description of the payee is not given it can be endorsed.

4. *Jawabee Hundi* :—This kind of hundi is drawn thus. The person desirous of making the remittances writes to the payee

and delivers the letter to a banker who endorses it to one of his correspondents near the payee's place of residence or negotiates it further. On its arrival the letter is forwarded to the payee who attends and gives his receipt in the form of an answer, which is forwarded through the same channel to the drawer.

5. *Zikri Chit* :—It is a letter of protection given to the holder by some prior party to the hundi to be used by him in case the hundi is not accepted.

*Note* :—Khoka is the name given to a hundi when paid up and cancelled.

**Cheque** :—Sec. 6 of the Act defines a cheque thus :—

“ A cheque is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.”

A cheque therefore, besides possessing the essentials of a bill of exchange, has got two more essentials *viz.*, (i) It is always drawn on a banker (ii) It is always payable on demand, and not after certain period from the date of presentation. Generally cheques are written on forms supplied by the banks to their depositors, with a view to prevent forgery.

The points of difference between a cheque and a bill of exchange are noted below:

- (i) A cheque is supposed to be drawn on the funds of the drawer in the hands of a banker, while there is no such presumption in the case of a bill of exchange.
- (ii) A cheque requires no acceptance apart from payment, while a bill, unless it is payable on demand, requires acceptance.
- (iii) A cheque is always drawn on a banker, while a bill may be drawn on any person.
- (iv) The drawer of a cheque is not discharged by failure of the holder to present it in reasonable time, unless the drawer has sustained damage by the delay. If the holder of a bill does not present it within a reasonable time for acceptance, or at maturity for payment he loses his remedy against the drawer, and the prior endorsers.
- (v) A cheque is always payable on demand without any days of grace for payment. A bill, unless expressed to be payable on demand, will carry with it three days of grace for payment.

(vi) No notice of dishonour is necessary in the case of a cheque. Such notice is absolutely necessary in the case of a bill.

(vii) A cheque is a revocable order and it may be revoked by countermand at any time before actual payment. But in the case of a bill there can be no countermand by the drawer after it is accepted.

*Note :* The drawing of a cheque does not amount to an assignment of the drawee's (customer's) moneys in the hands of the banker, and so even if the banker refuses payment the remedy of the payee is not to proceed against him but only to proceed against the drawer. Where however the drawer is discharged from liability on account of the omission of the payee to present the cheque in time, and the banks failure in that interval, the payee can rank as a creditor against the bank. A cheque can be drawn with its date ante-dated, or post-dated, provided it is not done with a view to commit fraud.

*Demand draft or Bank draft :—*It is an order drawn by one bank on one of its branches, or another Bank, in the form of a cheque. These demand drafts were held not to be cheques in *Capital and Counties Bank v. Gordon*, (1903) A. C. 240. But in order to protect banks from fraud arising from endorsements on them being forged, they are also treated as cheques and the rule laid down in S. 85 in the case of ordinary cheques has been extended to the payment of demand drafts. (Sec. 85 A).

*Marking or initialling :—*When a cheque is marked or initialled by a bank, it simply means that it is drawn in good faith on the funds of the drawer in the hands of the banker, and it gains additional currency.

In *Bank of Baroda Ltd. v. Punjab National Bank Ltd. and others*, 1944 (2) M.L.J. 275 (P.C.) it was held that marking or certification of a cheque by the bank as 'good for payment' on a future date, is not accepting within the meaning of the Negotiable Instruments Act, and that it cannot be regarded as acceptance, unless a custom can be established to treat it as such. It was also held that the law merchant is not a closed book, nor is it fixed or stereotyped.

*Drawee in case of need :—*When in the bill or in any endorsement thereon the name of any person is given in addition to the drawer to be resorted to in case of need, such person is called a 'drawee in case of need.' In English Law he is called 'referee

*in case of need* ' and by merchants '*case of need.*' The name of such a person is inserted either by the drawer, or by an endorser, to be resorted to in case the bill is not accepted, or paid in the usual course. There is some difference between the English Law and the Indian Law on this point. Resort to the drawee in case of need is optional in English Law, but according to Indian Law the holder must present the bill, whether for acceptance or for payment to the drawee in case of need ; otherwise the holder loses all his remedies. Sec. 115 enacts that a bill cannot be said to have been dishonoured unless it has been dishonoured by the drawee in case of need. Another point of difference is that according to English Law, a bill must be protested before it is accepted or paid by the referee in case of need. But according to Indian Law previous protest is not necessary.

**Acceptance :—**After a bill is issued the holder should present it to the drawee for acceptance in order to find out whether the drawee is willing to carry out the order of the drawer. If the drawee consents to obey the drawer's order he is said to accept the bill, which he does by signing his name on the bill, with or without the words '*accepted*'. Sec. 7 lays down:—"After the drawee of a bill has signed his assent upon the bill, or if there are more parts than one, upon one of such parts, and delivered the same or given notice of such signing to the holder or some person on his behalf, he is called the '*acceptor*'. The essentials of a valid acceptance are :—

1. It must be in writing, but it may consist of any words indicating the drawee's assent. Even a bare signature is enough. Generally the word '*Accepted*' is written across the face of the bill.

2. It must be signed by the drawee and an oral acceptance is not sufficient.

3. The acceptance and the signature must be on the bill itself whether on its face or back.

4. Acceptance must be completed by delivery of the bill.

5. An acceptance can be made only by the drawee, or all or some of several drawees, or a drawee in case of need, or an acceptor for honour, and none else (Sec. 33).

6. Where there are several drawees, an acceptance by one would not amount to acceptance by others, unless they are part-

ners, or the party accepting is an agent of the others, (Sec. 34). Where the bill is not accepted by all the drawees, the acceptance would be conditional, which the holder is not bound to accept.

7. An acceptance must be absolute and unconditional. The holder of a bill of exchange is not bound to consent to an acceptance which is conditional *viz.*, (a) where it declares the payment to depend upon the happening of an event; (b) where it undertakes the payment only of a part of the amount payable; (c) where it is qualified as to place; (d) where it is qualified as to time not found in the bill; (e) where it is accepted by some of the drawees only, when the drawees are not partners. If the drawee accepts such a conditional acceptance he loses all his rights against the previous parties unless their assent is obtained for the same. (Sec. 86). If the acceptor is induced to accept a bill on account of fraud, he will be liable thereon only to a holder in due course, but not to other holders. *Ayres v. Moore* (1940) 1 K. B. 278.

*Presentment for acceptance* :—If a bill of exchange is payable after sight, or is so expressed that it shall be presented for acceptance, or that it is payable elsewhere than at the place of residence or business of the drawee, it must be presented for acceptance. If no time or place is specified therein for presentment, it must be presented to the drawee for acceptance, within a reasonable time after it is drawn, during business hours on a business day. If no such presentment is made by the party entitled to demand acceptance, no party thereto will be liable thereon to the person making such default. If the bill is addressed to two or more drawees who are not partners, presentment must be made to all of them, unless one has authority to accept on behalf of all of them. Where the drawee is dead presentment may be made to his personal representative. Where the drawee is bankrupt presentment may be made to the Official Assignee, or Official Receiver as the case may be.

If the bill contains any direction as to the place for presentment, it must be presented at that place. If the drawee is not to be found after reasonable search the bill is dishonoured.

When there is an agreement or usage to that effect, presentment for acceptance can be made through post by means of a registered letter. (Sec. 61).

A promissory note payable at a certain period after sight must be similarly presented for sight, and in default of such

presentment no party will be liable to the person making such default (Sec. 62.)

According to Sec. 63 the holder must, if so required allow the drawee 48 hours, exclusive of public holidays, to consider whether he will accept it.

*When presentment for acceptance excused:*—In the following cases presentment for acceptance is excused :

1. Where the drawee after] reasonable search cannot be found.
2. Where the drawee is incompetent to contract.
3. Where the drawee is a fictitious person.
4. Where the drawee becomes bankrupt or is dead.
5. Where although presentment for acceptance is irregular acceptance is refused on some other ground.

*Dishonour by non-acceptance :*—A bill of exchange is said to be dishonoured by non-acceptance in the following cases :— (1) When the drawee or one of several drawees, not being partners makes default in acceptance upon being duly required to accept the bill ; (2) Where presentment for acceptance is excused and the bill is not accepted; (3) Where the drawee is incompetent to contract; (4) Where the acceptance is qualified. (Sec. 91).

*Note :*—Rules as to notice of dishonour considered *infra*.

*Acceptor for honour :*—When a bill of exchange has been noted or protested for non-acceptance, or for better security, and any person accepts it supra protest, for honour of the drawer, or of any one of the endorsers, such person is called an acceptor for honour (Sec. 7). An acceptor for honour is thus a person who voluntarily becomes a party to the bill by his acceptance, when the original drawee refuses to accept, or refuses to furnish better security when demanded by a Notary Public.

The essentials of a valid acceptance for honour are: (1) the bill must have been noted for non-acceptance, or protested for better security; (2) the acceptor for honour must be a person not already liable under the instrument; (3) the acceptance must be with the consent of the holder; (4) it must be by writing on the bill ; (5) he must declare in his hand that he accepts under protest the protested bill for the honour of drawer or of a particular

endorser named by him or generally for honour. Where a person for whose honour it is accepted is not mentioned, it shall be deemed to be for the honour of the drawer. (Secs. 108, 109 and 110).

*Liability of an acceptor for honour* :—An acceptor for honour can be made liable only if the following conditions are satisfied:—

- (i) The bill has at its maturity been presented to the drawee for payment, and (ii) has been dishonoured by him and (iii) noted or protested for such dishonour.

*Payee* :—“ The person named in the instrument to whom or to whose order the money is by instrument directed to be paid is called the payee.” (Sec. 7). It should be noted that the word ‘ payee ’ is used in the limited sense to indicate the person named by the drawer in the instrument and does not include the endorsee. But in practice it does not make any difference as Sec. 16 (2) applies the provisions of the Act relating to a payee to an indorsee, with necessary modifications. Where the payee is a fictitious or non-existent person the bill is treated as one payable to bearer. A bill though drawn in favour of an existing person will be deemed to be in favour of a ‘ *fictitious person* ’ if the person named is not intended by the drawer to take under the bill. *Bank of England v. Vagliano Bros.* (1891) A. C. 107. But where the drawer intends the payee to receive the amount under the bill, though he was induced to form that intention on account of fraud, the payee will not be a fictitious person. *North and South Wales Bank Ltd. v. Macbeth* (1908) A. C. 137. A negotiable instrument may be made payable to two or more payees jointly or it may be made payable in the alternative to one of two, or some of several payees. (Sec. 13 (2)).

*Payer for honour* :—Just as a person can intervene and accept a bill for honour, when it is dishonoured by non-acceptance, a bill protested for non-payment, can be paid for the honour of any party liable thereon, and such payment is called *payment for honour*, and the person so paying is called *payer for honour*. The essentials of a valid payment for honour are :—(1) The bill must have been noted or protested for non-payment; (2) Any person including a party already liable under the instrument can make the payment; (3) It must be for the honour of any party liable to pay; (4) The person so paying must declare before the



Notary Public, the party for whose honour the payment is made; (5) Such declaration must have been recorded by the Notary Public. (Section 113).

*Note* :—The payer for honour can recover from the party for whose honour he pays, all sums so paid with interest thereon and incidental expenses. (Sec. 114).

**Holder** :—“The ‘holder’ of a promissory note, bill of exchange or cheque means any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction.” (Section 8).

A holder must therefore have the possession of the instrument and also the right to recover the money in his own name. Thus persons having simply possession and not having the right to recover the money due thereon *e.g.* (a) the finder of lost instrument (b) a thief (c) a payee prohibited by an order of the court from receiving the amount (d) a payee who is an agent of another (e) a person taking under a forged endorsement, are not holders within the meaning of the section. Further the definition of a holder clearly excludes a person who may be really entitled to the money under the instrument, but whose name does not appear on its face, because the plea of benami and the law relating to benami transactions have no application to negotiable instruments. If the law were otherwise the speed with which monies due under negotiable instruments can be recovered in a court of law would be completely destroyed.

The section however does not affect the devolution of rights by operation of law. Therefore the legal representatives of a deceased holder, or the Official Assignee or Receiver in the case of an insolvent would certainly come within this definition.

*Note*.—The definition of holder is differently worded in the English Act but in practice there is not much difference between the two.

**Holder in due course**:—He is in English Law also called *bona fide holder for value without notice*. Section 9 defines thus :—“ ‘Holder in due course’ means any person who for consideration became the possessor of a promissory note, bill of exchange or

cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived the title." The definitions of holder and holder in due course are very important and should be clearly understood. Every holder is not a holder in due course, and it is only the holder in due course that is protected against all defects in the title of his predecessors.

A holder in due course should satisfy the following conditions:—(1) He should become a holder within the meaning of Sec. 8 before the amount mentioned in the instrument became payable, or in other words before the maturity of the instrument. If an overdue instrument is negotiated the holder takes it subject to any defect of title affecting it at its maturity. An instrument payable on demand is overdue when it appears on the face of it to have been in circulation for an unreasonable length of time. When a bill which is not overdue has been dishonoured, any person taking it with notice of the same takes it subject to any defect of title existing at the time of dishonour; (2) he must have become a holder for consideration *i.e.*, he must have become the payee or the endorsee of the instrument by furnishing consideration which is valuable, and is not fraudulent or unlawful. The passing of consideration between an endorser and an endorsee is important only for the purpose of showing whether the endorsee is a holder in due course. Even if an endorsee did not furnish any consideration, the maker or the acceptor cannot resist his (endorsee's) claim, provided his endorser was entitled to recover the money; (3) he should have become the holder without having sufficient cause to believe that any defect existed in the title of the person from whom he received it. *i.e.*, he should not have been aware of the defect in title of the party who transferred it to him. Therefore even if he is aware of the defective title of any prior party, he does not cease to be a holder in due course. Further the Indian Law requires that the holder in due course should not have had sufficient cause to believe that any defect in title existed *i.e.*, that he should not only be honest in taking the instrument but must exercise diligence in assuring himself that there are no defects in title. According to English Law, it is enough if he took the instrument *bona fide i.e.*, for value and

without knowledge of any defect in title, though he may have the means of knowledge if he had properly taken care of it. *Raphael and another v. Bank of England*, (1855) 17 C. B. 161. Title is said to be defective when it is obtained by practising fraud, duress, force, fear or other unlawful means, or for illegal consideration. According to Section 53 a holder of a negotiable instrument who derives a title from a holder in due course has the rights thereon of a holder in due course. In other words, even an endorsee who pays no consideration will have the rights of a holder in due course provided his endorser was a holder in due course.

*Holder for value* :—A holder in due course must be distinguished from a holder for value. A holder for value is one who holds a bill for which the value has, at some time, been given though not by the holder himself.

*Payment in due course* :—It means “payment (i) in accordance with the apparent tenor of the instrument (ii) in good faith (iii) without negligence (iv) to any person in possession thereof and (v) under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount therein mentioned” (Section 10). The maker, acceptor or indorser respectively of a negotiable instrument is discharged from liability thereon to all parties thereto, if the instrument is payable to bearer, or has been indorsed in blank, and such maker, acceptor or indorser makes payment in due course of the amount due thereon. (Sec. 82 (c) ).

*Dishonour by non-payment* :—“A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of a cheque makes default in payment upon being duly required to pay the same (Section 92).

*Inland Instrument* :—“A promissory note, bill of exchange or cheque drawn or made in British India, and made payable in or drawn upon any person resident in British India, shall be deemed to be an inland instrument.” (Section 11).

*Foreign Instrument* :—“Any such instrument not so drawn shall be deemed to be a foreign instrument.” (Sec. 11).

The two kinds of inland instruments are : (i) a bill of exchange drawn in British India on a person resident in British

India *e.g.*, a bill drawn by a merchant of Madras on a merchant of Calcutta, though it may be payable in British India or elsewhere; (ii) A bill drawn in British India and made payable in British India, though the drawee may be residing outside British India, *e.g.*, a bill drawn by a merchant of Madras on a person in London but payable in Calcutta.

Foreign instruments may be of five kinds :—

- (i) A bill drawn in British India on a person residing outside British India and made payable outside British India.
- (ii) A bill drawn outside British India and made payable in British India.
- (iii) A bill drawn outside British India on any person resident outside British India.
- (iv) A bill drawn outside British India on a person resident in British India.
- (v) A bill drawn outside British India and made payable outside British India.

*Note* :—Foreign bills are usually drawn in sets to avoid the risk of loss. (Supra).

*Payable to Order* :—“ A promissory note, bill of exchange or cheque is payable to order which is expressed to be so payable or which is expressed to be payable to a particular person, and does not contain words prohibiting transfer or indicating an intention that it shall not be transferable.” (Section 13 Expl. 1).

*Payable to bearer* :—“ A promissory note, bill of exchange or cheque is payable to bearer which is expressed to be so payable or on which the only or the last indorsement is an indorsement in blank ” (Section 13, Expl. 2).

*Payable to the order of specified person* :—“ Where a promissory note, bill of exchange or cheque, either originally or by indorsement, is expressed to be payable to the order of a specified person, and not to him or his order, it is nevertheless payable to him or his order at his option.” (Section 13, Expl. 3).

Therefore according to these explanations whether a promissory note, bill of exchange or cheque is drawn “ pay A or order ”, or simply “ pay A,” in either case it can be negotiated,

If, however, the right of negotiation is restricted by drawing it as 'pay A only' or 'pay A and none else,' the right of negotiation is lost, *i.e.*, A cannot transfer the instrument to another in accordance with the provisions of the Act.

### Negotiation

*Definition*:—"When a promissory note, bill of exchange or cheque is transferred to any person so as to constitute that person the holder thereof, the instrument is said to be negotiated" (Sec. 14). If the instrument is payable to bearer, or the last indorsement is an indorsement in blank it can be negotiated by simple delivery. Where it is payable to order, or the last indorsement on it is one in full it can be negotiated only by indorsement and delivery. (Sec. 48).

Negotiability is different from assignability. (*Supra*). Every actionable claim can be transferred according to S. 130 Transfer of Property Act, but only by means of a separate instrument in writing duly stamped. A negotiable instrument being an actionable claim can also be transferred according to the provisions of the Transfer of Property Act, in addition to being negotiated by an indorsement under the Negotiable Instruments Act. There is however a vital point of difference between the two. By means of a transfer under Sec. 130 Transfer of Property Act, the transferee will be entitled to all the rights of his transferor, to wit, the *debt* represented by the instrument, though he (the transferee) will also be subject to all the pleas and equities available against the transferor. By means of an indorsement under the Negotiable Instruments Act the indorsee (transferee) obtains only the property therein, (Sec. 50) *i.e.*—the right to recover the amount specified in the instrument, from the parties thereto, but not the debt based on the original consideration.

It was accordingly held by a Full Bench of the Madras High Court that an *indorsee* of a promissory note executed by the manager or karta of a joint Hindu family cannot avail himself of the right of the payee to proceed against the other members, (who are not parties to it) on the ground that the debt was contracted for the benefit of the family; unless that right was also—transferred to the indorsee under Sec. 130 Transfer of Property Act. *Maruthamuthu v. Kadir Badsha* I.L.R. 1938 Mad. 568 = (1938) (1) M.L.J. 378 (F.B.)

*Indorsement* :—" (1) When the maker or holder of a negotiable instrument (2) signs the same (3) otherwise than as such

maker (4) for the purpose of negotiation (5) on the back or face thereof or on a slip of paper annexed thereto or (6) so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said, to indorse the same and is called the indorser" (Sec. 15).

It is therefore clear from the section that no particular form is necessary for indorsement and that mere signature is enough. It is the intention of the signor to negotiate that is important. It may be made on the back or face of the instrument or on a slip of paper called an '*allonge*.' The endorsement can be made only by the maker or holder and none else, and when there are more than one all of them should endorse (Sec. 51). A stranger cannot endorse a negotiable instrument, nor does he by signing on the instrument become liable as an endorser. The endorsement should be completed by delivery of the instrument by the endorsee (Sec. 46). If the payee's name is wrongly spelt, he should indorse according to the spelling in the instrument and also add, if he thinks fit, his usual signature. If an endorser dies after making the indorsement but before delivering the instrument, it can be validly negotiated by his legal representatives, by a fresh endorsement and delivery, and not by mere delivery. It may be noted that it is not only instruments which are completed that can be endorsed, but also inchoate or incomplete instruments defined by Sec. 20. An endorsement is not valid unless it purports to transfer the entire amount represented by the instrument and not part of it.

*Indorsement in Blank and Indorsement in Full* :—“(1) If the indorser signs his name only, the indorsement is said to be in blank,” and if he adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the indorsement is said to be “in full”; and the person so specified is called the indorsee of the instrument. (2) The provisions of the Act relating to a payee shall apply with the necessary modifications to an indorsee (Sec. 16).

*Examples of special endorsement or endorsement in full* :—

1. “Pay Narayanarao.  
(Sd.) Ramarao.”
2. “Pay Narayanarao or order.  
(Sd.) Ramarao.”

An endorsement in blank consists only of the signature of the endorser, and an instrument endorsed in blank is payable to the bearer thereof even though originally, it was made payable to order. Whether the indorsement is in full or blank, the instrument must be delivered in order to complete negotiation.

*Classes of Indorsements* :—(1) Blank or general—already referred to; (2) Full or special—already referred to; (3) Restrictive—considered below; (4) Conditional—considered below.

*Effect of indorsement and restrictive indorsement* :—

“The indorsement of a negotiable instrument followed by delivery, transfers to the indorsee the property therein, with the right of further negotiation; but the indorsement may by express words restrict, or exclude such right or may merely constitute the indorsee an agent to indorse the instrument, or to receive its contents for the indorser or for some other specified person (S. 50.)

Unless the endorsement is restrictive an endorsement followed by delivery transfers not only the property in the instrument but also the right to further negotiate it. A restrictive endorsement may be made in any one of the following ways :—

- (1) Pay the contents to X only.
- (2) Pay X for my use; or on my account' or for collection.
- (3) Pay X for the account of Y.

In the first case the endorsement prevents further negotiation and is valid only between the parties *Hibernian Bank Ltd. v. Gysn* (1939) 1 K.B. 483. In the second case, the endorsee can neither transfer to a third person, nor hold the endorser liable to him because it constitutes the indorsee an agent of endorser for a special purpose. In the third case the title is vested in the endorsee in trust for some other person, and hence it restricts negotiation.

Therefore an instrument which is negotiable in its origin continues to be negotiable until (i) it has been restrictively indorsed; or (ii) payment or satisfaction thereof is made, at or after maturity but not afterwards. (Sec. 60).

*Conditional indorsement* :—“The indorser of a negotiable instrument may by express words in the indorsement exclude his own liability thereon, or make such a liability or the right of the indorsee to receive the amount due thereon depend upon the happening of a specified event, although such an event may never

happen. Where an indorser so excludes his liability and afterwards becomes the holder of the instrument, all intermediate indorsers are liable to him" (Sec. 52). Such an endorsement is called a conditional endorsement. *Example* of a conditional endorsement is "Without recourse." (Sd.) Ramarao.

By such an endorsement Ramarao does not incur any liability under the instrument. Conditional endorsement is also called 'qualified endorsement' or "sans Recourse" endorsement. It is different from a restrictive endorsement in that, while the latter restrains the negotiability of the instrument to a particular person or a purpose, a conditional endorsement does not affect negotiability but only excludes or qualifies the liability of the endorser.

*Delivery*:—After an instrument is made, accepted or endorsed it should also be delivered to the other party before any rights can be acquired by him. Therefore there cannot be a valid negotiation without delivery of the instrument whether actual or constructive. A promissory note, bill of exchange or cheque payable to bearer does not require any endorsement and can be negotiated by mere delivery. But when it is payable to order it is negotiable only by an endorsement whether it be in blank or full and by delivery thereof (Sections 46 to 48). *Supra*.

*Escrow* :—Though the making or indorsing of a negotiable instrument coupled with delivery transfers to the endorsee the property therein, yet if the instrument is delivered conditionally or for a special purpose only, and not for the purpose of transferring absolutely the property therein, it is called an 'escrow.' In such a case the property in the instrument passes to the endorsee subject to that condition. But if it comes into the hands of a holder in due course the condition subject to which it is delivered will be of no avail, and it can be enforced by him though the condition subject to which it has been delivered is not fulfilled (Secs. 46 and Excep. to Sec. 47).

*Conversion of Indorsement in blank into indorsement in full*:—  
"The holder of a negotiable instrument indorsed in blank may, without signing his own name, by writing above the indorser's signature and a direction to pay to any other person as indorsee, convert the indorsement in blank into an indorsement in full; and the holder does not thereby incur the responsibility of an indorser" (Section 49),



For example if a bill is drawn payable to X, and X endorses it in blank in favour of Y by merely putting his (X's) signature and delivering it Y becomes the holder of the bill. Y may endorse it specially to Z without putting his (Y's) signature, by merely writing "Pay Z or order" over the signature of X. The advantage of this procedure is that it operates as an endorsement in full from X to Z without Y incurring the responsibility of an endorser.

*Effect of making a special endorsement after an indorsement in blank :—*"If a negotiable instrument after having been indorsed in blank is indorsed in full the amount of it cannot be claimed from the endorser in full, except by the person to whom it is indorsed or by one who derives title through such person" (Section 55).

The English rule 'once a bearer instrument, always a bearer instrument', is not followed in India. The Indian rule is illustrated thus :—

A is the payee of a bill. He endorses it in blank and delivers it to B. B further endorses it in blank to C. C endorses it in full to D or order. D without endorsement delivers the same to E. E as the bearer of the instrument is entitled to sue the drawer, the acceptor or A or B. But he cannot proceed against C or D. D can sue C because he had received it by endorsement in full from C. If D instead of transferring it without endorsement to E, had transferred it by a regular endorsement, E can sue all prior parties.

The only case in which the rule 'once a bearer instrument always a bearer instrument' is applied in India, is to be found in (Section 85 (2) ).

*Inchoate or incomplete instrument :—*"Where one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments then in force in British India, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein and not exceeding the amount covered by the stamp. The person so signing shall be liable upon such instrument in the

capacity in which he signed the same to any holder in due course for such amount : Provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereunder " (Section 20). An inchoate or incomplete instrument is therefore one in which the sum payable or the name of the payee etc., are all not mentioned, or partly mentioned on a stamp paper signed and delivered by a person intending that the blanks should be filled up and a complete instrument created, and accepting the liability of a drawer, acceptor, or indorser thereunder. This section gives legal recognition to the practice of merchants who lend their credit by simply signing on blank stamped papers to be afterwards filled up as complete instruments. An inchoate instrument is different from an ambiguous instrument. In the case of an ambiguous instrument the courts act on the principle that a construction most favourable to the validity of the instrument should be adopted. In the case of an inchoate instrument the courts recognise the right of a holder to fill up the blanks, in an incomplete negotiable instrument, in accordance with the authority given to him by the person delivering it. It may be noted that the liability under this instrument arises only after the blanks are filled up, and the person delivering the incomplete instrument cannot be made liable by any one, other than a holder in a due course, for an amount larger than that for which authority was given by him.

*When amount is stated differently in figures and words :—*If the amount which is payable under a negotiable instrument is stated differently in figures and words the amount stated in words shall be the amount which has to be paid (Section 18).

*On demand, At Sight, On presentment and After Sight :—*A promissory note or a bill of exchange in which no time is fixed for payment and a cheque, are always payable on demand (Section 19). In a promissory note or a bill of exchange the expression 'At sight' and 'on presentment,' means 'on demand. The expression "after sight" means in a promissory note, after presentment for sight, and in a bill of exchange 'after acceptance, or noting for non-acceptance or protest for non-acceptance (Sec. 21). Though at sight' or 'on presentment' mean 'on demand' there is a difference between the two. In the case of an instrument payable at sight or on presentment it must be presented before payment can be

demanded and the period of limitation commences only from the date of such presentment ; but in the case of an instrument payable on demand, no demand or presentment is necessary, and the period of limitation commences from the date of its execution. Some instruments are drawn payable some time after sight or after date, in which case they become payable on their maturity.

*Usance* .—Instruments are sometimes drawn payable at one or more usances. A usance simply means the time fixed for payment of bills drawn in one country and made payable in another by the usage of the two countries. The duration of the usance varies with different countries.

*Maturity and Days of Grace* :—"The maturity of a promissory note or bill of exchange is the date on which it falls due. Every promissory note or bill of exchange which is expressed to be payable on demand, at sight or on presentment, is at maturity on the third day of the day on which it is expressed to be payable " (Sec. 22).

According to this section in the case of bills and promissory notes not payable on demand, the person liable has got two clear days' time, excluding the date on which it is expressed to be payable and the instrument will mature on the third day.

*Rules for calculating maturity*—A promissory note or bill of exchange payable a stated number of months after date is said to be at maturity on the third day after the day of the month corresponding with the date of the instrument. If the month in which the period terminates has no such day the instrument shall be held to be at maturity on the third day after the last day of such month. In calculating the date of maturity of an instrument payable a number of days 'after sight' or 'after date' the day on which the presentment for acceptance has been made or the day of the date should be excluded. If the day of maturity is a public holiday the instrument becomes payable on the next preceding business day. A public holiday includes Sunday, New Year's day, Christmas day, Good Friday and any other day notified in the Gazette by the Local Government as a public holiday. If the New Year's day or the Christmas day falls on a Sunday the succeeding Monday is also a public holiday (Secs. 23, 24 and 25).

### Parties to Notes, Bills and Cheques.

*Capacity to make etc., Promissory notes etc.* :—As in the case of every other contract, in the case of a negotiable instrument also a party to it must have contractual capacity, in order that he may be bound by his making, drawing or endorsing. Thus a minor or a lunatic cannot be made liable on an instrument as a maker or acceptor or indorser. When he is a party to an instrument as a drawer or an indorser, it is not rendered void on that account but it will be binding on all parties excepting himself. (Sec. 26).

An agent may be employed for the purpose of drawing, accepting or endorsing a negotiable instrument—but a general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or indorsing bills of exchange, so as to bind his principal. Further an authority to draw a bill of exchange, does not by itself confer an authority to endorse (Sec. 27). An agent should sign so as to indicate that he is signing as an agent and not intending to incur personal liability. Otherwise he becomes personally liable under the instrument, excepting to those, who induced him to sign upon the belief that the principal only would be held liable (Sec. 28).

In *Janakidas v. Kishan Prasad* 46 Cal. 663 (P.C.) certain hundies were drawn by a person describing himself as the Superintendent of the Private Treasury of H. H. the Maharajah Kishan Prasad, and without disclosing that any other person was liable as a principal. In an action on the bill it was held that the Maharajah was not liable. Their Lordships laid down that in an action on a negotiable instrument a person whose name properly appears as a party to it, cannot either by way of claim or defence show that the signatory was in reality acting for an undisclosed principal, and that having regard to the fact that such instrument constantly passes from hand to hand, it would be dangerous in the extreme to introduce any doctrine which permitted such evidence. Accordingly it was held that the description "Superintendent of the Private Treasury of His Highness" did not amount to a signature as an agent of the Maharajah, but only amounted to a description of the individual who signed it.

Some of the approved modes of signatures by an agent X acting for his principal Y, which would exclude his (agents') personal liability are as follows :

- (1) Y principal, by his agent X.
- (2) X for Y.

(3) Y by X.

(4) X agent for Y.

(5) Y sans recourse X.

(6) Per pro Y—X (Per pro means *per procuration* and is an expression for intimating that the agent has a special limited authority. A person who takes a bill or note so drawn, accepted or endorsed, is bound to enquire into the extent of authority of the agent).

(7) For Y—X.

Therefore a mere signature 'X agent of Y' would not absolve X from liability, and make Y liable, according to principles of law of agency. Where a guardian does not execute a promissory note as such on behalf of a minor, but executes it in his own name, he will be personally liable, though the money was borrowed for the benefit of the minor. But where the note is signed by the guardian as guardian, the minor's estate would be liable to discharge the debt covered by the promissory note, according to the general principles of Hindu Law.

In *Siva Gurunatha Pillai v. Padmavathi Ammal* I. L. R. 1941 Mad. 513 (F.B.) a promissory note in Tamil was executed in favour of X by S, son of V, the husband and agent and power of attorney holder of P, and it was recited therein that it was executed in respect of the debt due by the wife's junior paternal uncle. X sued S and P on the note. It was held that (i) circumstances not disclosed in the instrument cannot be looked into for the purpose of deciding whether the maker was personally liable, or whether he signed as the agent of another; and (ii) that in India when a person executes an instrument in an Indian language and after giving his own description adds that he is the agent of another, it means that he is acting as the other's agent in the matter of the execution of the document, and that it is sufficient to exclude his personal responsibility.

**Liability of legal representative signing** :—Section 29 of the Act lays down that "A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable personally thereon, unless he expressly limits his liability to the extent of the assets received by him as such." A specimen signature of a legal representative, which would exclude his personal liability, is therefore as follows :—X legal representative of Y, with recourse only against the estate of the deceased Y.

### Of Presentment for Payment.

A bill of exchange as already seen, may be dishonoured by non-acceptance, or after acceptance by non-payment. As promissory notes, and cheques, do not require acceptance, can be dishonoured only by non-payment. We have already considered the rules relating to presentment for acceptance, and the rules governing presentment for payment are considered below.

*Presentment for payment* :—Section 64 lays down that a negotiable instrument has to be presented for payment to the maker, acceptor or drawee thereof by or on behalf of the holder, and in default the holder will lose his rights against *all the other parties* to the instrument. When there is an agreement or usage to that effect, presentment for payment can be made through post-office by means of a registered letter.

*Note* :—A promissory note which is payable on demand and not payable at a particular place need not be presented for payment in order to charge the maker (Section 64).

Presentment for payment must be made during the usual hours of business (Section 65), and in the case of a promissory note or bill of exchange payable after a specified period presentment must be made after maturity. (Section 66). If the amount due under a promissory note is to be paid in instalments it should be presented on the third day after the date fixed for the payment of each instalment. (Section 67). If a promissory note, bill of exchange or cheque is made drawn or accepted payable at a *specified place and not elsewhere*, it must be presented for payment at that place, otherwise all the parties thereto will be discharged from liability. (Section 68). If a promissory note, or bill of exchange is expressed to be payable at a *specified place* simply, it must be presented for payment at that place. Otherwise only the maker or drawer of the instrument will be discharged from liability, and not the other parties (Section 69).

A promissory note or bill of exchange not expressed to be payable at any particular place has to be presented for payment at the place of business, if any, or at the usual residence of the maker, drawee or acceptor as the case may be. (Section 70). If such maker, drawee or acceptor has not got a known or fixed place of residence it may be presented to him in person wherever found. (Section 71).

*Presentment of cheque to charge drawer* :—A cheque must be presented at the bank on which it is drawn, before the relation between the drawer (customer) and the banker has been altered to the prejudice of the drawer, and in default he is discharged from liability. (Section 72). This rule is made subject to Sec. 84 which enacts as follows : Where a cheque is not presented for payment within a reasonable time of its issue and the drawer had sufficient funds with the banker at that time when the presentment ought to have been made entitling him to have the cheque honoured, but on account of the delay in presentment by the holder, the bank fails in the meanwhile and the drawer suffers actual loss, the drawer is discharged to the extent of the loss suffered by him; that is to say to the extent to which such drawer or person is a creditor of the banker to a larger amount than he would have been, if such cheque had been paid. What is reasonable time for presentment for payment, as has been already stated, is a question of fact depending on the nature of the instrument, usage of trade etc. The holder of a cheque as to which such a drawer is discharged loses his remedy against the drawer but will be entitled to recover the amount to the extent of such discharge, from the banker. (Section 84).

Thus if A gives B a cheque for Rs. 100 on a particular bank which had sufficient funds to pay the cheque but B presents the cheque only after an unreasonably long time, during which interval the bank fails and pays only a dividend of 70 per cent. to its depositors, A is discharged as to Rs. 100 but B has the right to rank as a creditor of the bank in the place of A and receive the dividend of Rs. 70.

Any party to a cheque, other than a drawer, is discharged from liability if the cheque is not presented within a reasonable time after delivery thereof by such person. (Sec. 73). It is not necessary, that the bank should have failed during the time it was not presented for payment. In order to charge a person other than the drawer presentment must be made within a reasonable time from the time of delivery by that person, and not from the date of its receipt by the holder of the cheque.

Subject to provisions of Sec. 31 presentment for payment in the case of a negotiable instrument payable on demand, must be made within a reasonable time after it is received by the holder. (Section 74).

Presentment for acceptance or payment as already stated can be made to the drawee, maker or acceptor as the case may be, or where any of them has died, to his legal representative or when he has been declared insolvent to the Official Assignee. (Section 75).

Though the Act lays down that presentment for payment or acceptance should be made within a reasonable time, still delay in such presentment is excused if it is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct or negligence. But where the cause for such delay ceases to operate, presentment should be made within a reasonable time from the date of such termination. (Section 75-A). This section was added during the first World War as a temporary measure but it was made a permanent rule by Act XXV of 1920.

*When presentment for payment unnecessary:*—An instrument need not be presented for payment, and can be treated as dishonoured in the following cases:—

- (i) If the maker, drawee or acceptor intentionally prevents the presentment, or
- (ii) If the instrument is made payable at his place of business and he closes it on a business day during business hours, or
- (iii) If the instrument is made payable at some other places and neither he nor his agent attends that place during the usual business hours, or
- (iv) If the instrument is not payable at any particular place and he cannot after due search be found, or
- (v) If the party who is sought to be charged, has engaged to pay notwithstanding non-presentment, or
- (vi) If the party sought to be charged, with the knowledge that presentment for payment has not been made, makes a part payment of the amount due under the instrument, or promises to pay the amount due thereon in whole or in part or waives his right to take advantage of the default in presentment for payment, or
- (vii) If the drawer is sought to be made liable and he could not suffer any damage from want of presentment. (Section 76).



### Notice of Dishonour

The drawer and the indorsers of a bill of exchange or cheque and the indorser of a promissory note cannot be sued by its holder unless a notice of dishonour, whether by non-acceptance or non-payment, has been given to them. But notice of dishonour to the maker of the dishonoured promissory note, or the drawee or acceptor of the dishonoured bill of exchange or cheque, need not be given because they are the parties primarily liable under the instrument (Section 93).

*Form of Notice:*—Notice of dishonour may be in any form and it may be given to the person entitled to such notice or to his agent, or his legal representative. It may be oral or written and if in writing can be sent by post. But it should contain the following particulars:—(i) That the instrument has been dishonoured; (ii) The way in which it is dishonoured; (iii) That the person to whom it is given will be held liable.

The notice should be given within a reasonable time after dishonour at his place of business, or if there is no such place at his residence. (Section 94).

*Notice by whom and to whom it should be given:*—Notice of dishonour may be given (i) by the holder of the promissory note bill of exchange or cheque, or (ii) by some other party liable under the instrument, or (iii) their agents and legal representatives.

This notice must be given to the drawer and to all other parties whom the holder seeks to make liable. If the holder seeks to make them severally liable it is necessary that notice should be sent to every one of them but if they are to be made jointly liable it is enough if the notice is given to anyone of them. (Sec. 93).

If the party to whom notice of dishonour is despatched is dead, but the party despatching the notice is ignorant of the death, the notice is sufficient. (Sec. 97).

*Notice of dishonour when excused:*—Notice of dishonour is not necessary in the following cases:—

- (i) When it is dispensed with by the party entitled to the notice ;
- (ii) In order to charge the drawer when he has counter-manded payment;
- (iii) When the party charged could not suffer damage for want of notice;

- (iv) When the party entitled to notice cannot after due search be found; or the party bound to give notice is for any reason unable, without any fault of his own, to give it;
- (v) To charge the drawers, when the acceptor also is a drawer;
- (vi) In the case of a promissory note which is not negotiable;
- (vii) When the party entitled to notice knowing the facts, promises unconditionally to pay the amount due on the instrument. (Section 98).

*Time for giving Notice:—*We have already seen that notice of dishonour should be sent within reasonable time after dishonour (Section 94). But any party receiving notice of dishonour must, in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time, unless such party receives notice for someone else. (Section 95). Where the instrument is deposited with an agent for presentment the agent is entitled to the same time to give notice to his principal as if he were the holder giving notice of dishonour, and the principal is entitled to a further like period to give notice of dishonour. (Section 96). In other words both the principal as well as the agent will be entitled to a reasonable time, each for the purpose of transmitting the notice of dishonour. The question, what is reasonable time is important as it arises not only in connection with notice of dishonour, but also in connection with presentment for acceptance or payment.

*Reasonable time:—*For presentment for acceptance or for payment, or for giving notice of dishonour, or for noting, reasonable time is determined having regard to the nature of the instrument and the usual course of dealing with respect to similar instruments. In calculating such time public holidays shall be excluded (Section 105). In other words reasonable time is a question of fact. What is reasonable time for presentment in the case of hundis may not be reasonable time for presenting cheques. In the case of bills of exchange when the place of drawing is too distant from the place where it ought to be presented for acceptance, a period of some day may be held to be reasonable for presentment. In the case of cheques they must ordinarily be presented, if the bank is in the same town in which they were drawn, on the day next following the day after they were received, because they are not intended to be in circulation for a long time

after they are received. Each intervening endorser is similarly entitled to a day.

*Reasonable time for giving notice of dishonour:*—If the holder and the party, to whom notice of dishonour has to be given, live or carry on business in different places, notice of dishonour will be deemed to have been given in reasonable time, if it is despatched by the next post, or on the day next after the day of dishonour. If the parties live or carry on business in the same place the notice is deemed to be given in reasonable time if it is despatched in time to reach its destination on the day next after the day of dishonour. (Sec. 106).

*Reasonable time for transmitting notice:*—A party receiving notice of dishonour who seeks to enforce his rights against a prior party will be deemed to transmit the notice within a reasonable time, if he transmits it within the same time after its receipt as he would have to give notice if he had been the holder.

#### Liability of a maker, drawer and acceptor.

*Liability of drawer:*—A bill of exchange may be dishonoured by non-acceptance or non-payment. When a bill of exchange is payable on demand, or on sight and it is not paid when duly presented, the drawer becomes liable to the payee for the amount which will place the payee in the same position as if the money had been duly paid by the drawee. Where the bill is payable certain time after presentment or acceptance, and it is accepted but not paid, the primary liability is that of the acceptor, and the drawer's liability is secondary. In either case the drawer can be made liable only if the payee, or the holder of the bill gives notice of dishonour to the drawer. Sec. 30 enacts: "The drawer of a bill of exchange or cheque is bound in case of dishonour by the drawee or acceptor thereof to compensate the holder provided due notice of dishonour has been given to, or received by the drawer, as hereinafter provided." The object in insisting on notice of dishonour being given to the drawer is to give him an opportunity to secure his rights against the drawee, before it is too late. The maker of a promissory note or cheque, the drawer of a bill of exchange until acceptance and the acceptor are in the absence of a contract to the contrary, respectively liable thereon as principal debtors, and the other parties thereto are liable

thereon as sureties for the maker, drawer or acceptor as the case may be." (Sec. 37). "As between the parties so liable as sureties, each party, is in the absence of a contract to the contrary also liable thereon as principal debtor to each subsequent party." (Sec. 38). The maker of a note and the acceptor of a bill before maturity are, in the absence of a contract to the contrary, therefore bound to pay the amount specified in the instrument according to their apparent tenor, and the acceptor of a bill at or after maturity is bound to pay the amount thereof to the holder on demand. In default of such payment the maker or acceptor is liable to compensate any party to the note or bill suffering loss by reason of such default. (Sec. 32). It is clear from the section that the payment ought to be according to the apparent tenor of the note, or acceptance, as the case may be; *i.e.*, the payment must be made to the party named in the instrument and not to any one else, and it must be made at maturity and not before. But this liability of the maker and acceptor is only subject to a contract to the contrary *e.g.*, as in the case of accommodation bills. An acceptor of a bill of exchange already endorsed is not relieved from liability, by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill. An acceptor of a bill of exchange which is drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder in due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer. (Secs. 41 and 42). Here the word 'fictitious' means that the name of a person was inserted by way of pretence without intending that payment should be made to him, whether a person bearing that name be existing or non-existing.

*Accommodation Bill*:—Accommodation bill is one whereon a person signs his name as drawer, acceptor or endorser without receiving any value therefor. It is a kind of loan raised on the strength of the commercial credit of that person by his signature (either as drawer, acceptor or endorser), for the benefit of another person who wants the loan. In the case of an instrument drawn for accommodation, if the party who is so accommodated pays the amount covered by the instrument, he cannot

recover the same from the person who became a party to it for his accommodation. (Sec. 43, Exception I). Thus if X accepts a bill for the accommodation of Y (the drawer), and if the holder Z collects the amount from Y (after dishonour by X) he (Y), cannot sue X because X is only an accommodating party. Therefore this is an exception to the rule mentioned in Sec. 32. But if such an accommodation instrument comes into the hands of a holder in due course, he can recover the amount from any prior party, including the person who subscribed his signature for the sake of accommodation. (Proviso to Sec. 59).

*Liability of the drawee of a cheque, or liability of a Bank :—* Section 31 lays down :—“The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and in default of such payment, must compensate the drawer for any loss or damage caused by such default.” It is clear from the section and from what has been stated already, that the liability of a bank in the event of its dishonour is only to the drawer and not to the holder of the cheque, because the contract between a banker and customer is that of a debtor and a creditor with the superadded obligation to honour the customers' cheques as far as funds permit. If a bank wrongly refuses to honour a cheque it is liable to pay damages, which may, be very heavy, if the customer happens to be a trader. A customer may, if the bank is prepared to allow him credit which is called overdraft, draw cheques for larger amounts than the funds to his credit ; but it is purely a matter of contract.

*When a bank can refuse to honour a cheque :—*In the following cases a bank will be justified in dishonouring the cheques drawn by the customer :—

- (1) When the customer has not got sufficient funds with the bank permitting the payment of the cheque. A bank is not bound to allow an overdraft. If a cheque is for an amount larger than the money with the bank, it is not bound to honour the cheque even to the extent of the funds available.
- (2) When the form of the cheque is of doubtful legality.
- (3) When the cheque is post—dated and it is presented before the ostensible date.
- (4) When the cheque is not presented during the banking hours.

- (5) When the funds with the banker are such that they cannot be made applicable to the payment of that cheque, *e.g.*, when moneys are held in trust and the cheque is drawn in breach of trust.
- (6) When there are material alterations, or the signatures of the drawer or endorsees are irregular.
- (7) When the bank has notice of the drawer being adjudicated insolvent.
- (8) When the customer has died and the bank has notice of his death.
- (9) When the drawer countermands payment.
- (10) When the cheque is presented at a branch of the bank where the customer has no account.
- (11) When the bank has received an order from a Court prohibiting payment out of the funds belonging to the customer.
- (12) When the bank has got a general lien on the customer's funds, and there are no funds available after the exercise of its lien, permitting the bank to honour the cheque.

*Liability of an Indorser* :—In the absence of a contract to the contrary, an endorser before maturity who has not excluded his liability or made his liability conditional, is bound to every subsequent holder—in case of dishonour by the drawee, acceptor or maker—to pay damages for any loss arising therefrom, provided due notice of dishonour has been given to such endorser. Every endorser after dishonour is liable as upon an instrument payable on demand. (Section 35).

*Discharge of liability of a Drawer and Indorser* :—1. As already stated an acceptor of a bill of exchange is a principal debtor while the other parties are his sureties. So if the holder of an accepted bill of exchange enters into a contract with the acceptor whereby he is released from liability (within the meaning of Section 134 Indian Contract Act), or the holder makes a composition with or promises to give time to, or not to sue the acceptor (within the meaning of Section 135 Contract Act) the other parties are all discharged. But if the holder at the time of conferring any such favour on the acceptor expressly reserves his right to charge the other parties, they will not be discharged. (Section 39).

2. Where the holder of a negotiable instrument without the consent of the endorser, destroys or impairs the endorser's remedy against a prior party, the endorser is discharged from liability to the holder to the same extent as if the instrument had been paid at maturity. (Section 40).

*Holder's right to a duplicate of a lost bill* :—If a negotiable instrument is lost before it is overdue, it is but just that the holder of the instrument should be supplied with a duplicate by its drawer. But the only hardship which can be pleaded by the drawer is that if the lost instrument gets into the hands of a holder in due course, he will have the right to proceed against the drawer and he may be made liable twice. To obviate this difficulty Section 45-A lays down that the holder can compel the drawer to give a duplicate of the lost instrument, but then the holder should furnish security to indemnify the drawer against all persons, in case the bill alleged to have been lost shall be found again. Section 45-A in terms applies only to a bill of exchange before it is due, but on equitable grounds this principle is applied to other kinds of negotiable instruments as well.

*Consideration in the case of Negotiable Instruments* :—After the decision of the House of Lords in *Rann v. Hughes* (1778), 7 T.R. 350, n., it has been well established that even in the case of contracts reduced to writing like negotiable instruments, consideration must be present in order that they may be enforced, Supra P. 24. The same principle has been followed in Section 43 which lays down that "a negotiable instrument made, drawn, accepted, endorsed or transferred without consideration, or for a consideration which fails, creates no obligation between the parties to the transaction." In other words between immediate parties, like the drawer and the payee of a bill of exchange, or a maker and a payee of a promissory note or an indorser and his indorsee, the amount due under the instrument will not be recoverable unless it is proved that the plaintiff furnished consideration. Where the consideration promised by the plaintiff was paid or performed only in part, he can recover only to that extent and no more. Thus for instance if A promising to pay Rs. 500 took a promissory note from B for that amount, but only paid Rs. 250, A cannot obtain a decree against B for more than Rs. 250 with interest. But on the other hand if no money has been paid by A the suit will have to be dismissed. (Sec. 44). But this plea of absence of consideration will not be available against a holder in due course. In the above illustration if A transferred the promissory note to C, a holder in due course, and C files a suit against B, he (B) cannot contend that he did not receive the entire or part of the consideration from A, as the case may be.

When a part of the consideration for which a person signed a negotiable instrument, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which the holder standing in immediate relation with the signor is entitled to receive from him is proportionately reduced (Section 45). Thus if a promissory note for Rs. 100 is executed towards the price of ten bags of rice, at Rs. 10 a bag, promised to be delivered by the payee, and he delivers only three bags the payee cannot recover more than their proportionate value, *viz.*, Rs. 30. But on the other hand if nothing has been mentioned about the price or the quality of rice in the several bags even if some of the bags have not been delivered as promised, the payee will be entitled to recover the entire amount of the note, because the partial failure of consideration cannot be estimated in money without a collateral enquiry. (Section 45). Of course the maker of the note will have his remedy in damages against the payee.

*Illegality of consideration*:—The law requires not only that there should be consideration, but also that the consideration should not be unlawful, and the means adopted for obtaining the instrument should not be unfair. Section 58 lays down that when a negotiable instrument is lost or has been obtained from the maker, acceptor or holder thereof by employing means which constitute an offence or fraud, or when the consideration for the instrument is unlawful, the person finding or so obtaining the instrument, or an endorsee who claims under him, will not be entitled to receive the amount mentioned in the instrument from such maker, acceptor or holder or from any party prior to such holder. But if the person possessing the instrument is a holder in due course, or claims through a person who is a holder in due course, this rule will not apply.

*Forgery*:—The rule that a holder in due course is not affected by defects in title does not apply to cases of forgery. Section 24 of the English Bills of Exchange Act is very clear on the point and it lays down that when a signature on a bill is forged, or placed thereon without the authority of the person whose signature it purports to be, the forged or unauthorised signature is wholly inoperative, and no one can acquire a right through or under the signature (a) to retain that bill, (b) to give a discharge therefor or, (c) enforce payment against any party thereto, unless the party



who is sought to be made liable is precluded from setting up forgery or want of title. The rule is strict and even a holder in due course cannot claim under an instrument when the signature of the party who is sought to be made liable is forged ; because forgery does not render the title simply defective, but conveys no title whatsoever. In other words forgery conveys no title. The Negotiable Instruments Act does not contain such an express provision but the law in India is also the same. Though forgery cannot be ratified, in certain cases a party will be estopped from setting up the plea of forgery : *Greenwood v. Martin's Bank*. (1933 A. C. 51).

To the rule that forgery conveys no title there are two exceptions to be found in Sections 85 and 85-A of the Negotiable Instruments Act. These sections are introduced in the interests of trade, and with a view to relieve the responsibility of bankers—which is already heavy—in the case of forged indorsements. Section 85 lays down that where a cheque payable to order purports to be indorsed by or on behalf of the payee, the drawee *i.e.*, the banker is discharged by payment in due course. In other words if the signature of the indorser appears to have been made by the very person named therein, even though it is forged, and there is nothing irregular or exciting suspicion in the endorsement, the banker is discharged from his liability by payment in due course. The person receiving the payment claiming under a forged indorsement will however be liable to refund the money received by him to the true owner. Sub-clause 2 to Section 85 has been added by the Negotiable Instruments Amendment Act of 1934 and it confers a further privilege on banks and it enacts:—  
“When a cheque is originally expressed to be payable to the bearer, the drawee is discharged by payment in due course to the bearer thereof notwithstanding any endorsement, whether in full or in blank, appearing thereon, and notwithstanding that any such endorsement purports to restrict or exclude further negotiation.”  
This sub-section was added with a view to remove the hardship created by the decision of the Bombay High Court in *Forbes Campbell & Co. v. The Official Assignee of Bombay*. 27 Bom. L. R. 34, and to bring the Indian Law into line with the English Law, which lays down “once a bearer cheque, always a bearer cheque.” Therefore according to this amendment in the case of cheques drawn payable to the bearer, the banker can safely ignore the endorsements and make the payment with perfect impunity

to the bearer. But a cheque originally made payable to order, but by endorsement converted into a bearer cheque is beyond the scope of this amendment.

Section 85-A extends the principle in Section 85 to Bankers' drafts, also called *demand drafts*. A demand draft is a bill of exchange or a cheque, drawn by one branch of a bank upon another and which is one payable on demand. Section 85-A is as follows :—"Where any draft, that is, an order to pay money, drawn by one office of the bank upon another office of the same bank for a sum of money payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course." The effect of this section is that a banker's draft is also a cheque within the meaning of the Negotiable Instruments Act. This section was added by Act XXV of 1930.

*Duty of Banker in payment of a cheque* :—It should be noted that a banker is protected by Section 85 only if the payment is made in due course *i.e.*, in good faith and without negligence, under circumstances not affording reasonable ground for believing that the holder is not entitled to receive the payment. Thus, if a cheque is 'stale' *i.e.*, one presented long after it was drawn, the practice of bankers is to refuse payment. In any of the cases enumerated under the heading "when a bank can refuse to honour a cheque" see *supra*, the payment by the banker will be deemed to be one which is not in due course, and would not discharge him from liability to the real owner. Further any patent irregularity in the endorsement, if overlooked by the banker, would not protect him from liability, *Slingsby v. Westminster Bank*. (1931) 2 K. B. 583.

Similarly where the bank disregarded the instructions given by the customer to the effect that bank drafts should be given only to constituents in foreign countries for the amounts specified in cheques drawn by the company, and issued bank drafts in the name of the manager of the company who misappropriated them, held that the bank was negligent: *Bank of Montreal v. Dominion Gresham Guarantee Co.* (1930) A. C. 659. Similarly when a power-of-attorney holder operates on his principal's account for the purpose of paying the amounts into his own accounts, and the bank allows such payments the bank is not protected.

In *Reckitt v. Barnett*. (1929) A.C. 176, an agent who was employed to invest his principal's moneys, withdrew from the bank a certain sum, and paid off his debts to the said bank, and executed a promissory note in favour of his principal, which was also kept with the bank, and the bank permitted this transaction without consulting the principal. *Held*: that the bank was liable to the principal in the said amount, as it has concurred in the transaction for its own benefit without an enquiry, though it was subject to a fiduciary obligation towards the principal. It was also held that this liability of the bank was in addition to that of the agent, and that even if the agent was subsequently released by the principal from liability, the bank could not escape liability, because its liability is not joint with that of the agent, nor is the bank his surety in that regard, *Imperial Bank of Canada v. Begley*. 44 M. L. W. 128 (From Canada).

It should be noted that the protection of the banker extends only to cases where the signature of the endorser is forged but not where the drawer's signature is forged. Therefore where the drawer's signature is forged and the bank honours such a cheque it is not protected, because the banker is supposed to know the signature of his customer and a cheque in which the drawers' signature is forged is no cheque at all.

The responsibility of a bank in collecting cheques of its customers is considered *infra* under the heading 'Non-liability of a banker in receiving the payment of a cheque'.

*Duty of customer towards Bank* :—In the earliest case of *Young v. Grote* (1827) B. O. E. R. 764 it was held that if a drawer draws a cheque in a way rendering it easy for a forger to make alterations, the drawer is bound to bear the loss and not the bank, because the customer owes a duty to the bank, to draw up his cheques so as not to invite or facilitate forgery or fraudulent alteration. This case has been criticised in subsequent cases, but the House of Lords approved the same in *London Joint Stock Bank v. Macmillan* (1918) A.C. 777, and held that a customer is bound to exercise reasonable care to prevent the banker from being misled, and if in breach of such duty, he draws a cheque in a manner enabling the committing of fraud the customer is responsible for the loss as a natural and direct consequence of his act. But the Privy Council in *Colonial Bank of Australasia v. Marshall* (1906) A. C. 559, held that the mere fact that a cheque is drawn with spaces left so that a forger can utilise them for purposes of forgery is not in itself a violation of the duty of the customer to the bank, and would not amount to

negligence on the part of the customer. The result of these two conflicting rulings, one by the House of Lords and another by the Privy Council, is that Macmillan's case will be followed in England, while the decision of the Privy Council in Marshall's case will be followed in India. It may be noted that even in England the principle laid down in *London Joint Stock Bank v. Macmillan* applies only to the drawer of a cheque and not to the drawer or acceptor of a bill of exchange.: *Scholfield v. Earl of Londesborough* (1896) A. C. 514. Even according to the decision of the House of Lords the duty of a customer is only to exercise reasonable 'care' in drawing cheques, but there is no duty on the customer to exercise precautions in the general way of carrying on his business and prevent forgeries etc. *Keptigala Rubber Estate Ltd. v. National Bank of India* (1909) 2 K. B. 1010.

*Instrument acquired after dishonour or when overdue :—*  
Though according to Section 60 a negotiable instrument cannot be validly negotiated after maturity so as to make the endorsee a holder in due course, it does not prevent endorsement altogether. The only consequence is that the holder of a negotiable instrument who has acquired it after dishonour, whether by non-acceptance or by non-payment, with notice thereof, or after maturity, has as against the other parties only the rights of his transferor (Sec. 59). In other words such a holder will not be a holder in due course. The exception to this section lays down that it does not prevent any person, who in good faith and for consideration becomes the holder after maturity of a note or bill made, drawn or accepted for the purpose of enabling some other party thereto to raise money thereon, from recovering the amount of the note or bill from any prior party. The effect of this exception is that in the case of accommodation bills or notes, a bona fide holder after maturity is in the same position as the holder before maturity, and can recover from parties prima facie liable on it. An example of the exception is as follows ;—A bill is payable 50 days after date. It is accepted by B for the accommodation of the drawer A. After the expiry of 60 days from the date of the bill, the drawer endorses the same to X for value and in good faith. X in this case can recover the amount of the bill from the acceptor (B) though he is only an accommodating party. It would be otherwise if there was an

agreement between A and B whereby A agreed not to negotiate it after maturity.

*Liability of banker for negligently dealing with bill presented for payment* :—Sec. 77 lays down as follows :—

“When a bill of exchange accepted payable at a specified bank, has been duly presented there for payment and dishonoured, if the banker so negligently or improperly keeps, deals with or delivers back such bill as to cause loss to the holder, he must compensate the holder for such loss.” A customer of a bank who has got an account with it may, while accepting a bill, accept it payable at that bank. A banker is not bound to honour a customer's acceptance unless there is an agreement with the customer to that effect. But the bank may do so, if it likes, even on the authority of the customer's acceptance. If a bank receives a bill for payment and dishonours it, it has to keep the instrument with care, and return it in the same state in which it was presented. Otherwise it would be liable in damages to the holder for any loss resulting from the bank's negligence.

#### Of payment and Interest

Payment of a negotiable instrument in order to be valid and discharge the maker or acceptor, must be made to the holder of the instrument. (Sec. 78). Therefore a payment to a person who is the real owner but whose name does not appear on the instrument would not discharge a maker or acceptor. Where interest is specified in the promissory note or bill of exchange, it shall be calculated at that rate on the principal money from the date of the instrument until tender or realisation, or until such date after the institution of the suit to recover such amount as the Court directs. (Sec. 79). Where interest is not specified, it shall be awarded at 6 per cent. per annum. An endorser when sought to be made liable will have to pay interest from the time he receives the notice of dishonour. (Sec. 80). Any person liable to pay under a negotiable instrument is, before payment, entitled to have it shown, and after payment to have it delivered up to him, or if the instrument is lost or cannot be produced to be indemnified against any further claim against him (Sec. 81).

**Of discharge from liability on Notes, bills and cheques**  
The maker, acceptor or indorser respectively of a negotiable instrument may be discharged from liability in the following ways :—

1. *Discharge by cancellation etc* :—"The maker, acceptor or indorser respectively of a negotiable instrument is discharged from liability thereon :—

- (a) to a holder thereof who cancels such acceptor's or indorser's name with intent to discharge him and to all parties claiming under such a holder;
- (b) to a holder thereof who otherwise discharges such maker, acceptor or indorser and to all parties deriving title under such holder after notice of such discharge;
- (c) to all parties thereto, if the instrument is payable to bearer, or has been indorsed in blank and such maker, acceptor or indorser makes payment in due course of the amount due thereon." (Sec. 82).

2. *Discharge by allowing drawee more than forty-eight hours to accept* :—If the holder allows the drawer more than 48 hours excluding public holidays, he (holder) loses his remedy to proceed against all the previous parties who have not agreed to such allowance.

3. *When cheque not duly presented and drawee is damaged thereby* :—The law is contained in Sec. 84 already referred to.

4. *Where a cheque is paid in due course, though some of the endorsements are forged* :—Secs. 85 and 85-A already referred to.

5. *When the acceptance is qualified or limited* :—If the holder of a bill of exchange acquiesces in a qualified acceptance, or one limited to a part of the sum mentioned in the bill, or which substitutes a different place or time for payment, or which is not signed by all the drawees who are not partners, all previous parties whose consent is not obtained to such acceptance are discharged against the holder, and those claiming under him, unless on notice given by the holder they assent to such acceptance. (Sec. 86).

6. *Material alteration* :—Material alteration of a negotiable instrument renders the same void even in the hands of an innocent holder, against anyone who is a party thereto at the time of making such alteration and does not consent to it, unless it was made for the purpose of carrying out the common intention of the original parties. If such alteration is made by an indorsee, it discharges the indorser from all liability to him even on the consideration. Filling up of blanks in the case of inchoate instruments, or conversion of a blank endorsement into an endorsement in full, or qualifying an acceptance, or crossing a cheque, are not

material alterations. (Sec. 87). But if a material alteration is made accidentally the instrument is not rendered void.

In *Hongkong and Shanghai Bank v. Lo Lee Shi* (1928) A.C. 181 (P.C.) the instrument was mutilated and effaced by the wash and ironing of the garment in which it was left. Held the instrument was not rendered void.

Similarly if a material alteration is made by a third party, without any fault on the part of the holder, the instrument is not rendered void.

*Examples of material alteration* :—If alterations are made in regard to the following, they are material alterations:—  
(i) Date. (ii) Time of drawing. (iii) Place of payment. (iv) Sum payable. (v) Medium of payment. (vi) Rate of interest. (vii) Number of parties to the instrument. (viii) The relation of parties. (ix) The legal character.

In the case of material alterations, a party guilty of the same cannot sue on the instrument. If the alteration is made by the endorsee, he cannot sue his endorser even on the original consideration. But if the payee or drawer is guilty of material alteration, the section does not say whether he can sue on the original consideration. Where however the alteration is not fraudulent but is innocent, the payee or the drawer would be permitted to sue on the original consideration, though the instrument is void.

It should be noted that an acceptor or endorsee is bound by his acceptance, notwithstanding any previous alteration of the instrument. Where the material alteration is not apparent and the payment has been made according to the apparent tenor of the instrument and in due course by a person liable to pay, it shall discharge such person from all liability therein. (Section 89).

7. *When the Bill comes into the acceptor's hands after maturity* :—If a bill of exchange which has been negotiated is at or after maturity held by the acceptor in his own right, all rights of action thereon are extinguished. (Section 90).

### Of Noting and Protest.

*Noting* :—When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may cause such dishonour to be noted by a Notary Public upon the instrument, or upon a paper attached thereto, or partly upon each.

Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reasons, if any, assigned for such dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary's charges. (Section 99).

*Protest* :—When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest.

*Protest for better security* :—When the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached before the maturity of the bill, the holder may, within a reasonable time, cause a notary public to demand a better security of the acceptor and on its being refused may, within a reasonable time, cause such facts to be noted and certified as aforesaid. Such certificate is called a protest for better security. (Section 100).

*Note* :—A holder can in addition to giving notice of dishonour cause the bill to be protested. An inland bill may or may not be protested. But according to Section 104, a foreign bill of exchange must be protested for dishonour if such protest is required by the law of the place where it is drawn. Noting is a step preceding protest. It is a memorandum of a minute recorded by a notary public upon the instrument itself or on a paper or partly on each. After the noting is done, protest can be drawn up by the notary public at his leisure. Protest is a formal certificate prepared by the notary public who attests the dishonour of the bill by non-acceptance or by non-payment or for better security. Noting has several advantages though it has not got the effect of a protest.

*Advantages of noting* :—They are: (1) Where a bill has to be protested within a specified time, it is sufficient if the noting is done within that time, and the protest may be drawn up later. (2) A bill can be accepted for honour under Section 108 after noting and protest is not necessary. (3) A payment for honour can also be made after noting though no protest is made.

*Advantages of protest* :—According to Section 119 a Court shall on proof of the protest presume the fact of dishonour unless and until such fact is disproved. The other advantages of protest



are:—1. It enables a bill to be accepted or paid for honour; 2. It provides authentic evidence of presentment and dishonour and enables the holder to have his remedy soon.

After a bill of exchange has been protested, notice of such protest must be given, instead of notice of dishonour, but subject to the same conditions. But notice of protest may be given by the notary public. (Section 102). If a bill of exchange is drawn payable at some place other than the place mentioned as the residence of the drawee and it is dishonoured by non-acceptance, it may without further presentment to the drawee be protested for payment in the place specified for payment, unless paid before or at maturity.

*Contents of a Protest*:—A protest under Section 100 must contain—

- (a) either the instrument itself, or a literal transcript of the instrument and everything written or printed thereupon ;
- (b) the name of the person for whom and against whom the instrument is protested ;
- (c) a statement that payment or acceptance or better security, as the case may be, has been demanded of such person by the notary public ; the terms of his answer, if any, or a statement that he gave no answer, or that he could not be found ;
- (d) when the note or bill is dishonoured, the place and time of dishonour and, when better security has been refused, the place and time of refusal ;
- (e) the signature of the notary public making the protest ;
- (f) in the event of an acceptance for honour or of a payment for honour, the name of the person by whom, of the person by whom, and the manner in which, such acceptance or payment was offered and effected. (Section 101).

*Note*:—The notary public can make the demand mentioned in clause (c) either in person or by his clerk or where authorised by agreement or usage by means of a registered letter.

*Rules as to compensation* :—Section 117 of the Act lays down the rules as to compensation in case of dishonour of a negotiable instrument as follows :—

“ The compensation payable in case of dishonour of a promissory note, bill of exchange or cheque, by any party liable to the holder or any indorsee shall be determined by the following rules:—

- (a) the holder is entitled to the amount due upon the instrument, together with the expenses properly incurred in presenting, noting and protesting it ;

(b) when the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between the two places;

(c) an indorser who, being liable, has paid the amount due on the same is entitled to the amount so paid with interest at six per centum per annum from the date of payment until tender or realisation thereof, together with all expenses caused by the dishonour and payment;

(d) when the person charged and such indorser reside at different places, the indorser is entitled to receive such sum at the current rate of exchange between the two places;

(e) the party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him, together with all expenses properly incurred by him. Such bill must be accompanied by the instrument dishonoured and the protest thereof (if any). If such bill is dishonoured, the party dishonouring the same is liable to make compensation thereof in the same manner as in the case of the original bill."

*Note* :—The bill referred to in clause (e) is called a '*Redraft*.' It may be drawn payable at sight or on demand on a party liable to the holder for the amount of compensation to which he is entitled according to the above rules. The redraft must be accompanied by the instrument which is dishonoured, and the protest if any. The dishonour of the redraft would entail the same consequences as if it were the original bill.

### Special Rules of Evidence

As stated at the outset the reason for the popularity of negotiable instruments amongst the mercantile community is due to the special privileges and rules of evidence applicable to them. The following are the special rules of evidence according to the Act :—

1. *Presumptions as to Negotiable Instruments* :—In the absence of proof to the contrary, the following presumptions shall be made :

- (a) that every negotiable instrument was made or drawn accepted or endorsed as the case may be, for consideration ;
- (b) that the date on the instrument is the date on which it was drawn ;
- (c) that every bill of exchange was accepted in a reasonable time and before maturity ;
- (d) that every transfer of an instrument is before maturity ;
- (e) that the endorsements appearing on the instrument are made in the order in which they appear ;

- (f) that the lost negotiable instrument was properly stamped ;
- (g) that the holder of an instrument is a holder in due course. But if the instrument was obtained from its lawful owner or from any person in lawful custody by means of an offence or fraud or obtained from the maker or acceptor by means of an offence or fraud or for unlawful consideration, the holder has to prove that he is a holder in due course. (Section 118).

In *Shanmuga Rajeswara Setupati v. Chidambaram Chettiar*, (1938) 1 M.L.J. 597 (P.C.) it was held that where a promissory note had been given, consideration should be presumed and that the burden of proving that no consideration passed was upon the maker of the promissory note.

II. *Presumption on proof of protest* :—In a suit upon a dishonoured instrument the Court shall presume the fact of dishonour on proof of protest until the contrary is proved. (Section 119).

III. *Estoppel against denying original validity of an instrument* :—The maker of a promissory note, the drawer of a bill of exchange or cheque and the acceptor of a bill of exchange for the honour of a drawer shall in a suit thereon by a holder in due course be estopped from denying the validity of the instrument as originally made or drawn. (Section 120).

IV. *Estoppel against denying capacity of payee to indorse* :—The maker of a promissory note and an acceptor of a bill of exchange payable to order shall be estopped from denying the payee's capacity at the date of the note or bill, to endorse the same. (Section 121).

V. *Estoppel against denying signature or capacity of a prior party* :—An endorser of a negotiable instrument in a suit thereon shall be estopped from denying the signature or capacity to contract of any prior party to the instrument. (Section 122).

### Rules and International Law

I. *Law governing liability of maker, acceptor or indorser of foreign instruments* :—Section 134 lays down as follows : "In the absence of a contract to the contrary, the liability of a maker or drawer of a foreign promissory note, bill of exchange or cheque is regulated on all essential matters by the law of the place where he made the instrument, and the respective liabilities of the acceptor and indorser by the law of the place where the instrument is made payable."

II. *Law of place of payment governs dishonour* :—Section 135 enacts "Where a promissory note, bill of exchange or cheque is

made payable in a different place from that in which it is made or endorsed, the law of the place where it is made payable determines what constitutes dishonour and what notice of dishonour is sufficient."

III. *Instrument made etc., out of British India but in accordance with its law* :—Section 136 lays down as follows : " If a negotiable instrument is made, drawn, accepted or indorsed out of British India, but in accordance with the law of British India the circumstance that any agreement evidenced by such instrument is invalid according to the law of the country wherein it was entered into does not invalidate any subsequent acceptance or endorsement made thereon in British India."

IV. *Presumption as to foreign law* :—Section 137 reads as follows : " The law of any foreign country regarding promissory notes, bills of exchange and cheques shall be presumed to be the same as that of British India, unless and until the contrary is proved."

*Notary Public* :—Sections 138 and 139 of the Act empower the Local Government to appoint persons who are to function as the Notaries Public under the Act, and also to frame rules for the guidance and control of such Notaries Public.

### Of Crossed Cheques

We have already considered the law relating to cheques which can be presented by the holder to the bank on which they are drawn, and which are paid across the bank's counter. They are called *open cheques*. But an open cheque lends itself to fraud and forgery by unscrupulous persons, causing loss either to the bank or to the customer. With a view to avoid such risks and protect the owner of the cheque, the system of crossing of cheques had been introduced in England by the English Crossed Cheques Act of 1876, which was later recognised by the Bills of Exchange Act. These provisions are also embodied in the Negotiable Instruments Act.

*Crossing is of two kinds* :—(1) General Crossing. (2) Special Crossing.

The effect of *general crossing* is to direct the banker not to pay the money across the counter, but to pay it only through a bank, so that it can easily be traced into whose hands the money

has been paid. On account of crossing, negotiability is not lost unless the words 'not negotiable' are used. Where it is a *special crossing*, the bank on which the cheque is drawn cannot pay the amount to any one except the bank specially named in the crossing. Therefore in the case of a general crossing, the holder cannot realise the amount unless he has an account with a bank, or negotiates it to a person who has got such an account. In the case of special crossing, the holder must have an account with that bank named in the crossing, or negotiate it to a person who has got an account with that bank.

*Account Payee* :—In this connection the practice of drawing cheques with the words 'Account payee' or 'Account payee only' may also be noted. The use of these words does not restrain the negotiability of a cheque, but it is merely intended to protect the drawer against theft or loss. These words may be added in addition to the crossing, and they indicate that the drawer desires that the receiving bank should collect the amount only for the benefit of the payee's account.

*Cheque crossed generally* :—Section 123 lays down as follows: "When a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or two parallel transverse lines simply, either with or without the words "not negotiable," that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally." Therefore a general crossing may be made for instance in any of the following ways :

I	II	III	IV	V
	and	& Co.	Not negotiable	Account payee—Not
	Company			Negotiable

But the simplest of all crossings is done by two parallel transverse lines.

2. *Cheque crossed specially* :—Section 124 lays down as follows : ‘ Where a cheque bears across its face an addition of the name of a banker, either with or without the words ‘ not negotiable ’ that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed specially, and to be crossed to that banker.”

A special crossing may be made for instance in any one of the following ways :—

I	II	III	IV
Imperial Bank of India Mount Road	Imperial Bank of India Mount Road	Account payee Imperial Bank of India Mount Road	Not negotiable Imperial Bank of India Mount Road

*Crossing after issue* :—We have already seen that Section 125 of the Act is one of the exceptions to the rule governing material alterations. Section 125 enacts :

Where a cheque is uncrossed, the holder may cross it generally or specially.

Where a cheque is crossed generally, the holder may cross it specially.

Where a cheque is crossed generally or specially the holder may add the words “ not negotiable”.

Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another bank as his agent for collection.”

In other words if a cheque which was not originally crossed is subsequently crossed either generally or specially by a holder, it does not amount to a material alteration. But crossing once made is a material part of the cheque and its alteration, except as stated above, is a material alteration. An important point to be noticed is that a cheque can be crossed specially only once, except in the case of a banker to whom it is crossed, who can cross it specially to another banker, his agent, for the purpose of collection. In England according to Section 77 (6) of the Bills of Exchange Act

a banker to whom an uncrossed cheque, or a cheque crossed generally is sent for collection can cross it specially to himself. This is done with a view to protect banks from the possible fraud by its clerks. According to Indian Law, a banker for collection cannot do so unless he is also the holder of the instrument.

*Payment of crossed cheques* :—The consequences or the advantages resulting from general or special crossing have been already noted. Section 126 of the Act lays down as follows :

“ When a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker.

When a cheque is crossed specially the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection.”

*Payment of cheque crossed specially more than once* :—Having already observed that a cheque cannot be crossed specially more than once, the consequence of violating that rule may be noted. Section 127 lays down : “ Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.”

*Payment in due course of a crossed cheque* :—Just as in the case of an open cheque a payment in due course by the banker discharges him from liability, in the case of crossed cheques also, a payment in due course would exonerate him from liability. The payment in the case of crossed cheques shall not be deemed to be in due course unless the provisions of Section 128 are complied with. Section 128 lays down : “ Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque and (in case such cheque has come to the hands of the payee) the drawer thereof shall respectively be entitled to the same rights and be placed in the same position in all respects, as they would respectively be entitled to, and placed in, if the amount of cheque had been paid to and received by the true owner thereof.”

Therefore if the banker pays in contravention of the crossing he cannot debit the customer's account with that amount but on the other hand will be liable to the true owner. *Bobbet v. Pinkett* (1876) 1 Ex. D. 368.

*Payment of crossed cheque out of due course* :—Section 129 lays down the rule thus : “ Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to the banker to whom the same is crossed or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.”

*Cheque bearing ‘ not negotiable ’* :—We have already seen that while crossing a cheque the words ‘ not negotiable ’ may be added. The effect of those words is that the cheque cannot be negotiated *i.e.*, the indorsee in such a case will not acquire a title better than his transferor. But they do not prohibit endorsement altogether. The position of an endorsee in those cases is only that of an ordinary transferee of a chose-in-action. This principle is laid down in Section 130 as follows : “ A person taking a cheque crossed generally or specially, bearing in either case the words ‘ not negotiable ’ shall not have and shall not be capable of giving a better title to the cheque than that which the person from whom he took had.”

In other words the endorsee of a cheque bearing the words ‘ not negotiable ’ will not be a holder in due course.

In *Great Western Railway Co. v. London and County Banking Co.* (1910) A.C. 414, one H by false pretences obtained from G.W. a cheque crossed “ & Co.” and ‘ not negotiable ’ and took it to a bank which paid it. It was held in a suit by G.W. against the bank for conversion of the cheque, that the cheque having been obtained by the fraud of H, he had no title to the cheque and consequently could not give to the bank any title to the cheque or the money, and that the bank was liable for the amount of the cheque.

*Liability of the collecting Bank* :—The introduction of the system of crossing cheques has imposed an additional duty on bankers, namely to collect cheques for their customers. The question which arises for consideration is what should be the position of a collecting bank which collects money in good faith for its customers when the holder of the cheque is not the real owner. Under the general law a person who collects money even in good faith for another, who is not the real owner, will be guilty of conversion and liable to the real owner in damages. If the protection afforded by law to the drawee bank, which makes payment in due course, is not made available to the collecting bank, the system of crossing cheques will amount to safeguarding the rights of the customer at the expense of his banker. To avoid this inequity the law has extended the same



protection to collecting banks, as to drawee banks, in the case of cheques which were crossed before they came into the banker's possession. A bank however cannot claim the protection by itself crossing the cheques after they are received by it.

The law is laid down in Sec. 131 as follows:—A banker who has (i) in good faith and (ii) without negligence received payment, (iii) for a customer of a cheque (iv) crossed generally or specially to himself, (v) shall not in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason *only* of having received such payment.

*Explanation* :—A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof.

In order that the collecting banker may not incur any liability by reason only of his having collected the amount for a customer, who is not the real owner, he must have acted without negligence. The question of negligence of the collecting banker arises for consideration when a customer sends for collection to his private account cheques which *ex facie* do not belong to him but to his principal or employer, towards whom he stands in a fiduciary relationship.

In *Morrison v. London County & Westminster Bank*, (1914) 3 K.B. 356, the manager of a firm of insurance brokers drew cheques as agent and fraudulently paid them into his own account with the defendants who collected the same for him for a number of years. It was held that the defendants were negligent in doing so because they had notice of the agency, and it was out of the usual course of business for an agent to draw on the principal's account and pay the money into the agent's private account. On the facts, however, it was held that the principal (plaintiff) by his conduct in adopting some of the transactions of the agent led the bank to believe that there was no harm in such collection, and that the defendant was therefore not liable.

Where a director of a company pays into his private account cheques drawn in favour of his company, the bank receiving the cheques for collection must make reasonable enquiries as to the director's right to deal with the cheque in that way. Otherwise the bank will be deemed to be negligent. *Underwood Ltd. v. Bank of Liverpool and Martins Ltd.* (1924) 1 K.B. 775.

It will also be negligence on the part of a bank when it receives payment of a cheque for a customer who draws it as agent for a third party in his

(customer's) own favour without enquiring about the customer's title to the cheque. *Midland Bank v. Reckitt* (1933) A.C. 1.

Similarly when a bank receives payment of a cheque for a customer when the cheque is drawn by the customer's employer in favour of a third party, or bearer, without enquiry as to customer's title to the cheque, it will be deemed to be negligent. *Lloyd's Bank v. Savory* (1933) A.C. 201.

A bank will be guilty of negligence when it ignores a direction on a cheque like "account payee" and receives it to the account of a person other than that indicated, or when it credits the amount of the cheque to the personal account of the managing director of a company, when it is payable to the company. *Midland Bank v. Reckitt* (1933) A.C. 1 and *Reckitt v. Barnett* (1929) A.C. 176. The bank will be guilty of negligence if it fails to note the difference between the name of the payee as given in the cheque and as given in the endorsement.

The explanation to section 131 was added in 1922, and it was necessitated by the decision of the House of Lords in *Capital and Counties Bank v. Gordon*, (1903) A.C. 240. In that case the bank credited the customer's account with the amount of the cheque as soon as the cheque was delivered to the collecting bank, and the customer was allowed to draw against the amounts so credited before the cheque was cleared. It was held that the bank did not have the protection extended to collecting banks, inasmuch as the money was not collected for the customer, but for its own sake as holder for value. This decision was construed as laying down that in every case when the collecting banker credits the customer's account with the amount of the cheque even before it is cleared, the protection given to a collecting bank is lost. The explanation which reproduces the section in the English Act negatives any such inference from the mere fact of the customer's account being credited with the amounts. So the position now is that when a customer pays a cheque into his bank account for collection, the mere fact that the bank credits him with the amount of the cheque, before it is cleared, does not make the bank a holder for value, unless the bank has so acted in pursuance of an agreement that the customer should be allowed to draw against cheques before clearance. *Underwood Ltd. v. Barclay's Bank*, (1924) 1 K.B. 775.

### Customer

Since a collecting bank is protected only when it collects money for its customer the question arises, who is a customer ? Broadly speaking a customer is a person who has the use and habit of resorting to the same place or person to do business. Lord Davey defines a customer thus : " I think there must be some sort of account either deposit or current account or some relation to make a man a customer of a bank." In another case, 'customer' was defined as " a person whose money has been accepted on the footing that the bankers undertake to honour cheques up to the amount standing to his credit irrespective of his connection being of short or long standing."

But mere casual acts of service rendered by a bank e.g., cashing a cheque for a friend of its customer, does not establish the relationship of banker and customer. *Commissioners of Taxation v. English Scottish and Australian Bank Ltd.* (1920) A.C. 683. A bank may itself be a customer of another bank, if the former has a drawing account with the latter.

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## PART II



## CHAPTER XXI

### COMPANIES

#### Introduction

*Historical* :—The Indian law relating to Companies is almost a copy of the English Law and both in India and England the law has been codified. The earliest Act in England was the English Companies Act of 1844 which was subsequently amended, and re-enacted, but it was finally replaced by the Companies Act, 1929. The Act now in force in England is the Companies Act of 1929, while that in India is the Indian Companies Act VII of 1913, as amended by the Companies Amendment Act XXII of 1936. The Indian Companies Act of 1913 is mainly modelled on the English Companies Consolidation Act of 1908. The latter Act was repealed by the Companies Act 1929, and with a view to bring the Indian law into conformity with the said English Act, and with a view to remove certain abuses discovered in the system of company management under the Act of 1913, the Indian Legislature passed the Companies Amendment Act XXII of 1936, which came into force on 15th January 1937. As the provisions of the English and the Indian Acts are almost identical, the English decisions are referred to by Indian Courts with very great advantage as useful precedents. The cases decided under the earlier Acts are of binding authority even under the later enactments, except in so far as the Acts provide otherwise.

The principal changes introduced by the Amendment Act of 1936 are in respect of the following topics :—

- (1) Powers of and remuneration to managing agents.
- (2) Definition of subsidiary and principal companies.
- (3) Meetings of share-holders.
- (4) Constitution and the working of Boards of Directors, and the powers of Directors.
- (5) Minimum subscription.
- (6) Profit and loss account.
- (7) Voluntary winding up of Companies.
- (8) Joint stock companies doing banking business.

*Preliminary :—*

The Indian Companies Act VII of 1913 as amended by the Indian Companies Amendment Act XXII of 1936 shall therefore be the subject of our study, and the references is hereafter relate to the said Act. The preamble to the Act states that it is enacted with a view to consolidate and amend the law relating to trading companies and other associations, and it is therefore not exhaustive of the law relating to all kinds of companies or associations.

Some of the important associations known to law are : (1) Companies incorporated by Royal Charter (2) Companies incorporated by special Acts of Parliament or the Indian Legislature. (3) Ordinary partnerships (4) Limited partnerships (5) Unincorporated companies (6) Companies registered under the English Companies Act of 1844 (7) Building societies (8) Industrial and Provident societies (9) Trade Unions.

A trading company or association registered under the Act may have some points of resemblance with the associations noted above, but the points of dissimilarity are too many and too fundamental to be lost sight of. Sec. 2 (2) simply states that “‘Company’ means a company formed and registered under this Act or an existing company,” but the word company unfortunately has not been defined in the Act. Generally speaking, a company means an association of a number of individuals formed for a common purpose. Lord Lindley defines a *company* thus : “By a company is meant an association of many persons who contribute money or money’s worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the *capital* of the company. The persons who contribute it or to whom it belongs are the *members*. The proportion of capital to which each member is entitled is his *share*”. A company may be incorporated by registration under the Companies Act or otherwise, or may not be incorporated. If it is incorporated it acquires what is known as a corporate status and will be called an incorporated company. Our study shall be confined only to Companies incorporated by registration under the Companies Act. Regarding Corporations generally, see Pp. 35, 36 (Supra). It is very essential to remember that the legal personality of a corporation is distinct and different from that of its members, and that the rights and liabilities of an incorporated

company are therefore different from those of its members. That is why in the case of a company with limited liability, the members who have fully paid up their share capital, cannot be made liable for the debts of the company.

It may now be stated that a company (by which we mean a company registered under the Companies Act) is a *corporation aggregate*, but every corporation aggregate is not a company, because a corporation can be formed otherwise than by registration under the Act. Thus a corporation can be formed by means of a Royal Charter i.e., a Charter granted by the Crown in exercise of the prerogative vested in it by common law e.g., The East India Company of 1600, the P & O Steam Navigation Company, 1840, the London Assurance Corporation of 1720, the Bank of England of 1674. These corporations however differ from companies, in that their members are under no liability for the debts of the corporation, as the Crown has no power at common law to attach liability to individual members of the corporation. Another mode of incorporation is by private or special Acts of Parliament or of Indian Legislature, for the purpose of carrying out extensive operations of public utility, such as Railway and Tramway Companies, Gas, Water and Electric undertakings. Resort was had in England to this mode of incorporation towards the end of the 18th century, when incorporation by Royal Charter was not only uncertain but also involved delay and considerable expense. These companies are governed by the terms of the special Acts by which they are created and by the general provisions of certain consolidating Acts e.g. the Companies Clauses Consolidation Act of 1845, the Railway Clauses Consolidation Act of 1845 in England. A noteworthy feature of the companies incorporated by Statute is that they are invested with powers enabling them to compulsorily acquire land, and do certain acts which, but for the statutory powers, would amount to nuisance. It may be noted that in addition to commercial undertakings several public utility corporations are formed by statute e.g. the Madras University Act, the Andhra University Act, the Madras Local Boards Act, the Madras District Municipalities Act etc. In England incorporation was also made for sometime by registration under Joint Stock Companies Act, 1844, which was passed with a view to obviate the difficulty which arose in suing the trading partnerships. But



it is interesting to note that the members of even those companies registered under the said Act were not immune from personal liability for the debts of the companies.

Building Societies, Industrial and Provident Societies are also corporations and resemble companies in many respects, but they are not really companies because they are not registered under the Companies Act.

Unincorporated companies are really large partnerships with transferable shares of a fixed amount formed by deeds of settlement between the shareholders on the one hand, and the trustees on the other. These companies are not really corporations and their formation is now forbidden by the Companies Act.

Trade Unions in England as well as in India are governed by separate Acts and not by the Companies Act and are therefore not companies.

We have already noticed that a partnership firm is different from an incorporated company Pp. 173, 174. (Supra). Limited partnerships, also called *partnerships en commandite* are associations established in England under the Limited Partnerships Act, 1907. These partnerships differ from the ordinary partnerships in that some of the partners (called *limited partners*) can limit their liability, provided there are one, or more partners (called *general partners*) with unlimited liability. The difference between these two types of partners is that a general partner can, while a limited partner cannot, take part in the management of the partnership business. These limited partnerships ceased to be popular in England as members could limit their liability effectively by forming a company with limited liability under the Companies Act. In India, it may be noted that there is no Act corresponding to the Limited Partnerships Act of England. These limited partnerships, it is needless to add, are not companies.

*Advantages conferred by registration under the Act.*

The objects with which company legislation was passed were chiefly two in number: (1) to enable funds being raised for the purpose of large and sometimes speculative undertakings by means of contributions from a number of small capitalists, and (2) to minimise risk in the event of a loss by spreading the liability, and in particular to restrict the liability of the members to a limited amount. These two objects could not successfully be

achieved by the formation of a firm, or any association other than an incorporated company. The other advantages gained by a company are: (1) the transferability of its shares, (2) the continuity of the concern notwithstanding the death or bankruptcy of its members, (3) the vesting of its management in a select body of directors, and (4) the freedom both in its formation and working. It is the English Companies Act of 1862 (a master piece of legislation) that has secured all these advantages, and also the precious privilege of carrying on business with limited liability; to companies which are registered under it. The framers of that Act have done away with the old cumbersome and costly methods of obtaining incorporation, and have substituted the simple and inexpensive procedure of registration for the formation of a company, viz., filing before the Registrar of Joint Stock Companies a printed document called the memorandum of association, signed in the case of a public company by seven and in the case of a private company by 2 persons desirous of getting themselves incorporated, with or without another printed document called the articles of association, signed by the signatories to the memorandum of association, both of them being duly stamped, and obtaining the certificate of incorporation. It is no exaggeration to say that company legislation is a great boon to traders as well as to the investing public, and is largely responsible for the growth of industrial and commercial enterprise in both the countries.

*Application of the Act :—*The Indian Companies Act applies to the following companies: (1) Companies formed or registered under the Act (2) Existing companies (3) Companies registered but not formed under Act XIX of 1857 and Act VII of 1860 or either of them or under the Indian Companies Act 1866 or 1882. These companies according to Sec. 251 are governed by the Act only to the extent mentioned in Sec. 266 (Sec. 251) (4) Companies registered under the Act in pursuance of provisions contained in part VIII shall be governed only to the extent specified in Section 266. (5) Companies which are unregistered will be governed for the purpose of winding up under Part IX of the Act (Secs. 270 and 276). (6) Foreign companies or companies incorporated outside British India which comply with the requirements of Sec. 277,

*Note:*—The Act does not apply to (1) Companies incorporated by means of Royal Charter, or (2) by Special Acts, or (3) Life Assurance Companies or (4) Imperial Bank of India, or (5) Companies of which winding up was commenced before the commencement of the Act, (Secs. 284, 287 and 289).

*Definitions :—*

Sec. 2 of the Act purports to define certain words used in the Act but they are not definitions in the real sense. They would be referred to in their appropriate places.

*Jurisdiction of Courts:*—Sec. 3 of the Act lays down that the court having jurisdiction under the Act is the High Court, having jurisdiction in the place at which the Company's registered office is situate, but power has been given to the Local Government to empower any District Court to exercise all or any of the jurisdiction conferred upon the High Court, in regard to companies having registered offices in that district. The expression 'registered office' for the purpose of jurisdiction to wind up companies has been defined as the place which has longest been the registered office of the company during the six months immediately preceding the presentation of the petition for winding up, but nothing in the section would invalidate a proceeding by reason of its being taken in a wrong Court.

*Illegal partnerships and associations :—*Though nothing is stated in the Partnership Act about the maximum number of partners that can lawfully be associated as a firm, Sec. 4 of the Indian Companies Act lays down that not more than 10 persons shall join for the purpose of carrying on the business of banking, and not more than 20 persons shall join for the purpose of carrying on any other business for gain, unless the said company association or partnership is registered under the Companies Act, or incorporated by means of Royal Charter, or Act of Parliament, or of the Central Legislature etc. Thus the law now makes it obligatory that all companies or associations for profit should be incorporated, when they consist of more than 10 in the case of banking business, and more than 20 in the case of other business. This rule however does not apply to a Hindu Joint family carrying on joint family *trade*. If however two joint families carry on business as a firm and if the total number of members of

both the families, excluding minor members, exceeds the aforesaid number, the partnership must be registered as a company. With a view to discourage the existence of unincorporated associations in violation of this rule, it is also laid down that every member thereof shall be personally liable for the liabilities incurred in such business, besides being liable to a fine not exceeding Rs. 1000. The object of this provision is to prevent the mischief, arising from trade being carried on by large fluctuating bodies, so that persons dealing with them may not know with whom they were contracting and so may be put to great expense, which is a public mischief to be repressed. *Smith v. Anderson* (1880) 15 Ch. D. 247 at p. 273.

Thus, where three firms entered into a partnership agreement for carrying on non-banking business for profit, and the aggregate number of partners of all those firms exceeded twenty, it was held that the partnership agreement was illegal (even though the number of firms was only three) because a partnership firm is not a person in the eye of law. It was also held that a suit for dissolution and accounts of such a firm would not lie. *Senaji v. Pannaji* 59 M.L.J. 435 (P.C.)

A sub-partner in a firm not being a partner will not be counted for the purposes of Sec. 4 of the Act. It may be noted that the section will not apply if the association is not one carrying on business for profit.

#### *Consequences of illegality:—*

An association offending Sec. 4 is a phantom and has no legal existence. Consequently such an association is under the following disabilities :—

(1) It cannot enter into a contract or contract any debt, and hence a member or an outsider cannot maintain a suit against the association on the foot of such a contract. (2) It cannot be sued by any of its members in respect of matters connected with the association. (3) Its members cannot sue for partition of its properties, or any other relief. (4) It cannot be wound up under the Act at the instance of the association, or a creditor, or a shareholder. (5) It cannot sue a member or a third party when the illegality is patent (6) Its members are personally liable for the liabilities of the association,

*Note:*—Though a suit by a third party against an illegal association is not maintainable, it lies against the members of such association, unless the plaintiff is *particeps criminis* i.e., a party to the illegality. It has been held that, though an illegal association cannot be wound up under the Act, the Court will order an account of the moneys received by the officers of such an illegal association, and an enquiry as to who are the members. *Greenberg v. Cooperstein* (1926) Ch. 657.

### General Classification of Companies

Companies can be classified as follows :—

(1) Private and public companies (2) Subsidiary and holding companies (3) Banking companies (4) Joint Stock and other companies authorised to register under the Act.

(1) Private company :—

A company which can be registered under the Companies Act may be either *private* or *public*. A private company is generally formed to take over a flourishing business carried on by an individual or a firm and also obtain the privilege of limited liability. A private company confers more advantages on its members than a partnership firm or public company. We have already noticed that a partner cannot escape personal liability in respect of the debts contracted by the firm. A public company should comply with a number of provisions of the Act which would give publicity to its dealings and affairs, and in some respects lacks freedom of management. With a view to avoid these disadvantages private companies are generally formed.

Sec. 2 (13) defines a “private company” as a company which by its articles (1) restricts the right to transfer the shares, if any, and (2) limits the number of its members to 50, not including persons who are in the employment of the company, and (3) prohibits any invitation to the public to subscribe for the shares, if any, or debentures of the company. Where two or more persons hold one or more shares in the company jointly they shall for the purposes of this definition be treated as a single member.

“Public company” on the other hand is defined by Section 2 (13-A) as a company incorporated under this Act, or under the Indian Companies Act, which is not a private company.

According to the definition the number of members in a private company should not exceed fifty, but it has not said anything about the minimum number. Sec. 5 however lays down that in the case of a private company the minimum number of persons for purposes of incorporation is two. Private companies came to be recognised in India for the first time by the Companies Act of 1913. Prior to the said Act all companies registered under the Companies Acts were public companies.

The main points of difference between a private company and a public company are as follows :—

PRIVATE COMPANY.

- (1) It cannot have more than 50 members.
- (2) Its articles must contain restrictions on the right to transfer its shares.
- (3) It cannot extend invitation to the public to subscribe for its shares, or debentures.
- (4) It can be incorporated even by two persons.

PUBLIC COMPANY.

- (1) There is no upper limit to the number of its members.
- (2) There cannot be any such restriction.
- (3) There is no such restriction.
- (4) It cannot be incorporated unless the number of its members is at least seven.

*Privileges of a Private Company.*

A private company enjoys certain privileges in that it need not comply with some of the provisions of the Companies Act ; viz.

(1) The regulations relating to the rotation of directors and their appointments (Articles 78 to 82 of table A) do not apply to a private company, because a private company need not have any directors (83-A).

(2) Consequently even if there be a director his consent in writing to act as such, and his contract to take up the qualification shares, need not be filed with the Registrar, nor is it necessary for him to sign the memorandum for any qualification shares.

(3) A private company cannot issue a prospectus, or a statement in lieu of prospectus, and consequently it need not file the same with the Registrar, (Sec. 98).

(4) It need not hold a statutory meeting nor file a statutory report, (Sec. 77).

(5) It can commence business immediately after incorporation and need not observe any other formalities (Sec. 103).

(6) It can proceed to allotment of shares even if the minimum subscription has not been subscribed or paid (Sec. 101).

(7) Its directors can vote on contracts in which they are interested, and its manager or agent need not file in the office of the company the memorandum of a contract which he enters into in his own name, without disclosing the name of the principal (company). (Sec. 91 B and 91 D).

(8) It need not file with the Registrar or send to its members, preferential share holders, or debenture holders its balance sheet and auditor's report, (Secs. 131 and 146).

(9) It can employ an uncertified auditor or a person in its service as an auditor. [Sec. 144 (1) ].

*Note*.—A private company must send with the annual list and summary, a certificate by its director or secretary, a statement that the company has not since the date of its last return issued any invitation to public to subscribe for any of its shares, or debentures, and that the number of members does not exceed 50. [Sec. 32 (4) ].

A private company is also called a 'one man company,' which means that practically all the shares are held only by one man, who has the sole control of its management and who is the moving spirit of the concern. At one time it was doubted whether such a company was validly constituted but all doubts have been set at rest by the memorable decision of the House of Lords in *Salomon v. Salomon & Co.*, (1897) A. C. 22 :—

Salomon was carrying on business as a leather merchant, which he sold to a newly formed company called Salomon & Co. Out of the shares in the company he took 20,000 shares, his wife, 4 sons and a daughter, each took one share, and no other shares were issued. Salomon received mortgage debentures to the tune of £10,000 in part payment of the price of the business sold by him to the company. The business suffered reverses and it had to be wound up. The assets of the company amounted only to £6,000 while the company had to pay £10,000 to Solomon on mortgage debentures, and £7,000 to unsecured creditors. It was contended on behalf of the unsecured creditors that Salomon & Co., was the same person as Salomon, and that he could not owe money to himself, and that they should be paid first their £7,000. The House of Lords reversing the decision of the courts below held that the only mode of ascertaining the intent and meaning of the Act was to examine its provisions and find out what regulations it had imposed as a condition of trading with a limited liability, and that in that view the company had an existence independent from that of Salomon, as the requirements of the Companies Act regarding registration had been complied with. Halsbury. L. C. observed that the Statute enacts nothing as to the extent or degree of interest which may be held by each of the seven members, or as to proportion of interest or influence possessed by one or majority of the share holders over the others. It was also observed that once the company is incorporated it must be treated like other independent persons, and the motives of those who promoted it are irrelevant. It was therefore held that the company could not be an agent for Salomon, that the company was not defrauded at all as all the share-holders knew all about it, that the company was a person different from

the subscribers to the Memorandum, and that consequently Salomon could keep £6,000 in part payment of the debenture loan due to him from the company.

*Note* :—A one man company very often is, but need not necessarily be a private company. It may also be a public company, provided that almost all the shares are held only by one individual and the other members are mere dummies.

*Conversion of a private company into a public company* :—

Sec. 154 lays down the following rules for converting a private company into a public company:

(1) The articles must be so amended as to remove the restrictions on the number of members, and the right to transfer its shares, and to permit invitation to the public for subscription; and

(2) It shall within a period of 14 days after the said date file a prospectus or statement in lieu of prospectus with the Registrar. If these conditions are satisfied it becomes a public company. Where a company's articles satisfy the requirements of those of a private company but they are not complied with, it shall not be entitled to the privileges and exemptions referred to above, and it shall be bound by the provisions of the Act as if it were a public company. It may however be relieved by the Court on its being satisfied that the said non-compliance with the articles was due to inadvertence or accident (Sec. 154). If the number of members of a private company is below two, its sole member will be liable for all the debts of the company during the time he carries on the business after six months as the sole member, and the court may even order the company to be wound up [Secs. 147 and 162 (iv)].

*Note* :—Sec. 154 only speaks of a private company being converted into a public company but not vice versa. But there is nothing in the Act prohibiting such a conversion and a company may be converted from public company into a private company by means of a special resolution, provided its articles are amended so as to satisfy the requirements of Sec. 2 (13), and the other consequential alterations are also made.

#### Subsidiary and Holding companies

The Amendment Act of 1936 has recognised and defined the position of subsidiary companies, whether they are incorporated



under the Companies Act or not. That was done because several public companies have become related to subsidiary companies and the financial position of the public companies largely depended on that of the subsidiary companies. A subsidiary company is defined by Sec. 2 (2) as follows :—

If a company holds (1) more than 50% of the issued share capital or 50% of the voting power, or (2) possesses the power to appoint majority of directors of another company, that other company will be called the *subsidiary company*, and the company holding the power as aforesaid will be called the *holding company*. A subsidiary company may in its turn have a subsidiary company, provided the aforesaid conditions are satisfied. In counting the number of shares held by one company in another, for determining whether or not they are related as holding and subsidiary companies, the shares of another company held only as security by a company which carries on the business of money lending shall not be counted. A subsidiary company may be either a public or private company. Some of the provisions of the Act are, as already noticed, not made applicable to a private company, but if a private company is the subsidiary of a public company, the Act is made applicable to it as if it is a public company. Sec. 132 (a) imposes a liability on a holding company to disclose various matters concerning the subsidiary company in its balance sheet so that the members of the holding company may get sufficient information about the subsidiary company.

### Foreign Companies

A company incorporated outside British India, but having a place of business in British India, is known as a foreign company, and in order to be entitled to carry on business in our country it has to satisfy the following requirements: (1) It must within one month from the establishment of its place of business in British India file with the Registrar in the Province in which such place is situate, a certified copy of the charter, statute, or memorandum and articles of the company, full address of the registered office of the company, a list of directors and managers of the company, and the names and address of persons resident in British India who are authorised to accept service of notices on behalf of the company; (2) It must file every year with the Registrar of the Province, a copy of its balance sheet which

would satisfy the provisions of the Indian Companies Act; (3) If the foreign company uses the word limited as part of its name, it shall state in every prospectus the country of its incorporation and also exhibit on every place of business in India, in its bill heads, letter papers, notices, advertisements and other publications, the name of the company and the country in which it is incorporated in legible English characters, and also in one vernacular language if the business is carried on at a place outside the original jurisdiction of the High Court. If the liability of the members of the company is limited, it must cause notice of that fact to be stated in legible characters in the documents above referred to and it should be affixed at every place where it carries on business.

*Note :—*A notice addressed to the person notified for service of process, or left at the office notified with Registrar, shall be deemed to be served on the foreign company.

Sec. 277 (A) lays down certain conditions to be satisfied before a foreign company can issue, circulate or distribute a prospectus, offering to the public its shares or debentures and Sec. 277 (B) enumerates the particulars to be specified in every prospectus issued by a foreign company. Sec. 277 (C) prohibits hawking from house to house the shares of a foreign company. Sec. 277 (D) enacts that Secs. 109 to 117, and Secs. 120 to 125 (i.e., the provisions dealing with the information as to mortgages and charges, the registration of mortgages and rectification of register of mortgages etc.) shall apply to foreign companies. Sec. 277 (E) applies Secs. 118 and 119 (dealing with the notice of appointment of a Receiver, and Sec. 130 dealing with the keeping of proper books of account) to foreign companies.

### Banking Companies.

One great improvement made in the existing law by the Indian Companies Amendment Act of 1936 is to provide a separate chapter (part X-A) entitled "Banking Companies." Though the business of banking has grown in popularity and volume in our country, the Legislature has not passed comprehensive legislation dealing with all banking companies. The necessity for such legislation is obvious because the crash of a banking company brings about the ruin of its share holders as well as its numerous

depositors. The Reserve Bank of India Act dealt with this problem but only to a limited extent, as it confined its attention only to big banks known as the 'scheduled banks.' The activities of smaller banking companies however remained unchecked. It is with a view to fill this lacuna that the Legislature incorporated in the Indian Companies Act a new chapter (Secs. 277-F to 277-N) dealing with banking companies. The importance of this chapter lies to a large extent in its definition of banking business. The provisions now enacted in respect of banking companies may be summarised as follows:—

(1) Banking business has been defined, and the kinds of business which can lawfully be carried on in addition to it, have been specified.

(2) The system of managing agency for banking companies is forbidden.

(3) Insistence is made on the working capital of the bank being at least 50,000 rupees and its unpaid capital being not charged.

(4) The maintenance of a reserve fund and cash reserve by every banking company is made obligatory.

(5) The court can grant moratorium to a banking company which is temporarily unable to make its obligations.

*Definition of Banking Company* :—A banking company means a company which carries on as its principal business, the accepting of deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order and it is called the *main business*. In addition to this business a banking company is permitted to carry on any one or more of the following kinds of business:

(1) the borrowing, raising or taking up of money ; lending of money either upon or without security, the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes and other instruments and security, whether transferable or negotiable or not, the buying, selling and dealing in bullion and specie, the acquiring, holding, issuing on commission, underwriting and dealing in stocks, shares, debentures etc., and investments of all kinds;

(2) acting as agents for Government or local authorities;

(3) contracting for public or private loans, and negotiating and issuing the same;

(4) promoting, insuring, guaranteeing, underwriting etc., of any issue of State, Municipal or other loans, or of shares, stocks etc., of any companies;

(5) carrying on and transacting every kind of guarantee and indemnity business.

(6) financing any business, undertaking, or industry;

- (7) acquisition of any property which the company thinks necessary;
- (8) selling and realising property in satisfaction of its claims;
- (9) acquiring and dealing with any property which forms any part of the security for any loan advanced;
- (10) the administration of estates as executor, trustee or otherwise ;
- (11) taking or acquiring of shares in another company having objects similar to its own ;
- (12) aiding or establishing funds, trusts, associations etc., calculated to benefit employees, or ex-employees or their dependants;
- (13) construction, acquisition etc.. of any works for the purposes of the company;
- (14) selling, improving etc., any part of the property, rights etc., of the company;
- (15) acquiring the whole or part of any business of a nature enumerated above; and
- (16) doing all such other things as are incidental or conducive to the promotion of the business of the company (Sec. 277-F).

Sec. 277-G lays down that no company formed for the purpose of carrying on banking business or using as a part of its name, the word bank, banker or banking, shall be registered under this Act, unless the memorandum restricts its objects to the main business and only to some or all of the forms of business specified in Sec. 277-F. If any bank already in existence on the date of the commencement of the Companies Amendment Act carries on any business other than those specified in Sec. 277-F it should cease to do so after the expiry of two years thereafter. Power is given to the Governor-General-in-Council to add any form of business which can be lawfully carried on by a bank in addition to those enumerated in Sec. 277-F. Sec. 277-H forbids a banking company from employing after two years from the commencement of the Companies Amendment Act a company other than a banking company as its managing agent. According to Sec. 277-I the banking company shall not commence business unless shares have been allotted to an amount sufficient to yield at least Rs. 50,000 as working capital, and unless a declaration by the directors and the manager, that such a sum has been received by way of paid up capital, has been filed with the Registrar. A Banking company cannot create a charge on its uncalled capital and even if created it is invalid (Sec. 277-J). Every Banking company shall maintain a *reserve fund*, and out of the declared profits of each year and before dividend is

declared, transfer at least 20% of such profits to the reserve fund until it is equal to the paid up capital. The reserve fund shall be invested in the Government or other approved securities. (Sec. 277-K). A banking company shall maintain by way of cash reserve at least  $1\frac{1}{2}\%$  of its time liabilities and 5% of demand liabilities of such company and a statement showing the amount so held shall be filed with the Registrar every month. "*Demand liabilities*" means liabilities which must be met on demand and "*time liabilities*" means liabilities other than demand liabilities (Sec. 277-L). A banking company is prohibited from holding shares in any subsidiary company except a subsidiary company of its own formed for the purpose of undertaking and executing trusts and such other purposes set forth in Sec. 277-F which are incidental to the main business (Sec. 277-M). The court on the application of a banking company which is temporarily unable to meet its obligations, is given the power to stay the commencement, or continuance of all actions and proceedings against the company for a specified period on such terms as it thinks fit (Sec. 277-N).

#### Companies authorised to register under the Act.

Certain companies though not formed under the Companies Act or those preceding it, are permitted to be registered under the Act. (Secs. 253 to 269 deal with this particular subject.) Sec. 253 lays down that the following companies can be registered under this Act: (i) A company consisting of 7 or more members which was in existence on the 1st day of May 1882 including any company registered under Act 19 of 1857 and Act 7 of 1860 or either of them, and (ii) any company formed after the aforesaid date, in pursuance of any act of Parliament or of the Governor-General-in-Council (other than this Act) or of Letters Patent or being otherwise legally constituted and consisting of seven or more members. The companies so registered may be either limited by shares, or by guarantee, or of unlimited liability, and the registration shall be valid even if it has taken place only with a view to being wound up. The restrictions imposed on such registration are as follows :

- (1) A company having a liability of its members limited by an Act of Parliament or Act of the Governor-General-in-Council, or of Letters Patent

shall not be registered under this section unless it is a Joint Stock Company. Further a company which is not a Joint Stock Company cannot be registered as a company limited by shares.

(2) A company having its liability limited by Act of Parliament or Act of Governor General-in-Council or by Letters Patent shall not be registered as an unlimited company or a company limited by guarantee.

(3) A company shall not be registered without the assent of a majority of its members at a general meeting summoned for the purpose.

(4) If a company not having its liability limited by Act of Parliament or of the Governor General-in-Council or Letters Patent is to be registered as a limited company the assent of  $\frac{3}{4}$  majority of the members present shall be required.

(5) If a company is to be registered as a company limited by guarantee the assent of the majority shall also be accompanied by a declaration of each member agreeing to pay a sum not exceeding the amount guaranteed.

(6) A company registered under the Indian Companies Act, 1882 shall not be registered under this section. (Sec. 253).

#### *Joint Stock Company:—*

For the purposes of Sec. 253 to 269, as far as they relate to registration of companies as companies limited by shares, a joint stock company is defined as "a company having a permanent paid up or nominal share capital of fixed amount divided into shares also of fixed amount, or held and transferable as stock, or divided and held partly in one way and partly in the other, formed on the principle of having for its members, the holders of those shares or that stock, and no other persons; and such a company when registered with limited liability under this Act shall be deemed to be a company limited by shares." (Sec. 254), Sec. 255 and 256 enumerate the documents which should be filed before a company is to be registered as (1) joint stock company or (2) other than joint stock company respectively, and the contents of such documents.

Sec. 257 deals with authentication of statements and Sec. 258 empowers the registrar to require evidence for being satisfied whether a company proposed to be registered is or is not a joint stock company. Sec. 259 lays down that if a banking company which was in existence on the 1st day of May 1882 proposes to be registered as limited company, it shall give 30 days notice of that fact to its customers (Sec. 259). All property movable and immovable and all obligations as may belong to or be vested in the company on the date of its registration shall on registration pass to and vest

in the company as incorporated under this Act (Sec: 263). The registration shall not affect its existing rights or liabilities or suits or other legal proceedings by or against the company pending on the date of registration. (Sec. 264 and 265). Sec. 266 applies to such companies the provisions of the Act subject to certain qualifications.

### Formation and registration of a company

A company cannot come into being of its own accord, and the steps necessary for its formation are therefore usually taken by a person called a promoter. He has to do the following for forming a company :

- (1) Preparation of memorandum of association.
- (2) Preparation of articles of association.
- (3) Entering into preliminary contracts, if any.
- (4) Registration of the company.
- (5) Preparation and issue of a prospectus or a statement in lieu of prospectus.

### Modes of forming an Incorporated Company

An incorporated company may be formed in one of three modes :

(1) *A company limited by shares i.e.* a company having the liability of its members limited to the amount, if any, unpaid on the shares held by them.

(2) *A company limited by guarantee i.e.* a company having the liability of its members limited to such amount as the members respectively undertake to contribute to the assets of the company in the event of its being wound up. Clubs and associations for promoting various objects are examples of this.

(3) *An unlimited company i.e.* a company not having any limit on the liability of its members. (Sec. 5).

The first kind of company is the most popular one and is referred to hereafter, while the other two kinds are referred to only where necessary. A company limited by guarantee may also have a capital divided into shares. An unlimited company may be registered with or without a capital divided into shares,

### Memorandum of Association

#### *Definition and General Features :*

Memorandum of association, also called memorandum, is a document of utmost importance in regard to a proposed company, and specimen forms of the same for companies limited by shares, and companies limited by guarantee and not having share capital, are given in the Act as Forms A and B respectively in the II schedule. Sec. 2 (10) defines memorandum as "the memorandum of association of a company as originally framed or as altered in pursuance of the provisions of this Act". It is needless to add that this definition is not helpful. The memorandum of a company contains the conditions of incorporation, and the company's powers are limited to the provisions laid down therein. It cannot be altered save in exceptional cases and only in certain matters, subject to the conditions laid down in the Act. It is as it were the foundation on which the entire structure of the company rests and is therefore rightly regarded as the charter of the company. The memorandum not only shows the object of its formation but also defines and limits the utmost possible scope of its operation and activity, and hence great care should be exercised in drafting this document. Originally this charter of the company was considered to be so sacred that it was regarded in England till 1890 as unalterable, but subsequently provision had been made in the Acts for the alteration of the memorandum in certain respects. Thus Sec. 10 of the Act lays down that a company shall not alter the conditions contained in the memorandum, except in the cases and in the mode and to the extent for which express provision is made in the Act. Sections 11 to 16 provide for alteration of the name of the company, the place of the registered office, and the objects of the company, and the procedure to be followed in respect of the same. The proviso to Sec. 10, added in 1936, makes it clear that the conditions relating to the appointment of a manager, or managing agent and other matters of a nature incidental or subsidiary to the main objects of the company shall not be deemed to be conditions within the meaning of Sec. 10. In other words the proviso lays down, following the decision of Bombay High Court in *Ramkumar v. Sholapur Spinning and Weaving Company* 59 Bom. 218, that the provisions relating to managing director or the managing agent or the secretary etc., even though inserted



in the memorandum, do not become conditions of the memorandum, and can therefore be altered as freely as articles of association.

### Contents of Memorandum

In the case of a *company limited by shares*, the memorandum shall state :—

1. the name of the company with “limited” as the last word in the name ;
2. the province in which the registered office of the company is to be situate ;
3. the objects of the company ;
4. that the liability of the members is limited ;
5. the amount of share capital with which the company proposes to be registered, and the division thereof into shares of a fixed amount.

*Note*:—Each subscriber shall take at least one share and he shall write opposite to his name the number of shares he takes. (Sec. 6).

In the memorandum of a *company limited by guarantee* clauses 1 to 4 mentioned above, must be stated, but instead of clause 5 it should be stated that each member undertakes to contribute to the assets of the company, in the event of its being wound up while he is a member, or within one year afterwards, for payment of the debts and liabilities of the company contracted before he ceases to be a member and of the costs, charges and expenses of winding up and for adjustment of the rights of the contributories among themselves, such amount as may be required not exceeding a specified amount. If such a company has a share capital, the particulars mentioned in clause 5 above shall also be stated (Sec. 7),

In the memorandum of an *unlimited company* clauses 1 and 3 in the memorandum of a company limited by shares must be mentioned and if it has a share capital, each subscriber of the memorandum should take at least one share, and shall write opposite to his name the number of shares he takes. (Sec. 8).

### 6. Association clause and subscription :—

Every memorandum of association of a public company shall be signed by 7 persons who are desirous of being formed

into an incorporated company. If it is a private company it is enough if the memorandum is signed at least by two such persons (Sec. 5).

*Note*:—Every memorandum shall be (1) printed; (2) divided into paragraphs numbered consecutively; and (3) signed by each subscriber (member) in the presence of at least one witness who shall attest the signature. The member shall also state his address and description (vide Forms A and B of the II schedule) (Sec. 9.)

The rules relating to each of these clauses in the memorandum may now be noted.

### 1. The name of the company.

According to Sec. 11 the following restrictions are imposed on the choice of a company's name :

(i) It should not be identical with that of a company already in existence nor so closely resembling it as is calculated to deceive except where the company already in existence is in the course of winding up, and it signifies its consent to its name being assumed by the new company. This clause is obviously intended to avoid confusion in the mind of the public who have to deal with the companies and also protect the rights of companies already existing. The registrar may therefore refuse to register a company which contravenes this rule. Even if the registrar registers it, the other company may obtain an injunction and have the name removed from the register of companies. *Societe Panhard et Levassor v. Panhard Levassor Motor Co., Ltd.* (1901) 2 Ch. 513. It is however, open to a company which has violated this rule through inadvertance or otherwise to change its name, with the sanction of the registrar.

(ii) The name should not contain the words "Crown" "Emperor" "Empire" "Imperial" "Royal" "State", "Reserve Bank", and such other words, which suggest or are calculated to suggest the patronage of His Majesty or any member of the Royal family, or any connection with His Majesty's Government.

(iii) The name should not contain the words "municipal" or "chartered" or any word suggesting connection with any municipality or local authority or with any society incorporated by Royal Charter.

*Note* :—A company can, however, use the words prohibited in clauses (2) and (3) above as a part of its name with the previous consent in writing of the Governor-General in Council.

Subject to the above restrictions, a company can choose any name it likes, but where the liability of the company is limited, the last word in the company's name must be "limited". To this rule an exception has been provided for in Sec. 26, which lays down that, in the case of a limited company formed for promoting art, science, religion, charity or any other useful object and applies or intends to apply its profits, if any, or other income in promoting those objects and prohibits the payment of any dividend to its members, the Local Government may permit such a company to be registered without the addition of the word "limited" to its name. Such a company nevertheless enjoys all the privileges and will be subject to all other obligations of a limited company. The Local Government is empowered to revoke the said licence after giving due notice to the company.

*How to change company's name* :—

A company already registered with a particular name can change it by a *special resolution* and subject to the approval of the Local Government in writing. The registrar shall then enter the new name in his register and issue a certificate of incorporation with the altered name.

*Note*.—A change of company's name shall not affect any rights or obligations of the company nor render defective any legal proceedings by or against the company. Legal proceedings already started against the company by its former name may be continued against it by its new name. (Sec. 11).

## 2. Registered office of the company

The place where the registered office is to be situated and the Province in which it is to be situated are important because they determine the domicile of the company, and the jurisdiction of courts. Sec. 6 (ii) requires only the province in which the registered office is to be situate to be mentioned in the memorandum, but not the place. But Sec. 72 requires that every company should within 28 days after its incorporation, or from the day on which it begins to carry on its business whichever is earlier, have a registered office, and also intimate the situation

of the same and the changes, in the situation if any, from time to time to the registrar. The situation of the registered office must be made known because that is the place where the several registers and accounts of the company have to be kept and to which all notices to the company should be addressed. The registered office can be shifted from one province to another by a *special resolution* confirmed by the Court on a petition filed for the purpose. For changing the situation of the registered office within the same province an *ordinary resolution* and a notification to the registrar would suffice.

### 3. The object clause of the company

This is really the most important among the clauses in the memorandum. It both defines and limits the scope of the company's activities and hence it is permitted to be altered only to a limited extent, and with the sanction of the Court. Great care has therefore to be exercised in framing the objects clause, and in making its terms sufficiently wide so as to secure to the company every power which it would like to exercise after incorporation. This object clause is said to have a two-fold effect: (1) positive i.e. stating what powers are possessed by the company, and (2) negative i.e., stating what powers are not possessed by the company. Therefore a company cannot do anything outside the powers given in the memorandum, and even if it does it is *ultra vires* (beyond the powers of) the company and void, and it cannot be validated even if all the members assent to it. *Ashbury Railway Carriage and Iron Co. v. Riche* (1875) L. R. 7 H. L. 653.

In this case a company was given power by its memorandum to make and sell railway carriages. Its directors bought a railway concession in Belgium for laying a railway line. The articles empowered the company to extend the object specified in the memorandum by a special resolution and in exercise of this power the company passed a special resolution after purchasing the concession, so extending the objects as to validate the purchase. The House of Lords held that the purchase of the concession was *ultra vires* and void, and had not become valid by reason of the consent of the members.

This rule is obviously intended to protect the shareholders and the public at large, who deal with a company on the basis of the object clause in the memorandum of association. Even where a power such as "to do all other such things as are incidental or conducive to the attainment of the above objects" has been added in a memorandum after stating some objects, it was held

that it would render valid only operations relating to the business for which powers have been given, and would not cover acts relating to a new business not covered by the memorandum.

Though a company has got much freedom in framing its object clause, it is subject to two qualifications : (1) it should not infringe the general law, e.g., a power cannot be given to a company to carry on the business of smuggling goods or running a lottery or any other illegal business; (2) it should not infringe the provisions of the Companies Act e.g., the memorandum cannot authorise a company to purchase its own shares, *Trevor v. Whitworth* (1887) L.R. 12 A.C. 409. If a particular act is *ultra vires* the memorandum, even a ratification by all the members (shareholders) would not validate it. If the act is only *ultra vires* the articles but *intra vires* the memorandum, the articles can be suitably amended and the act can be validated. If the act is only *ultra vires* the directors, the shareholders can ratify it.

*Interpretation of the object clause:*

Whether a particular act is *ultra vires* or *intra vires* the company depends upon the interpretation of the object clause in the memorandum. The following are some of the well known rules which are followed by courts with regard to its interpretation :—

1. The entire document must be read.
2. The words used must have their ordinary meaning.
3. Technical words should be read in their technical sense.
4. The words should be read with reference to the subject matter.

In *Simpson v. Westminster Palace Hotel* (1860) 8 H.L.C. 712 it was held that the memorandum should be read fairly and not in a restricted sense, and acts which are preliminary and conducive to the main object of the company should not be deemed to be *ultra vires* if they are not otherwise objectionable.

A later decision of the House of Lords held that the acts of a company though really for its benefit were *ultra vires*, because they were not provided for in the objects clause. *Ashbury Railway Carriage and Iron Company v. Riche* (1875) L.R. 7 H.L. 653 (Supra). In this case Lord Cairns L.C. referring to the effect of a memorandum observed “it states affirmatively the ambit and

extent of vitality and power which by law are given to the corporation and it states, if it is necessary to state, negatively that nothing shall be done beyond that ambit and that no attempt shall be made to use the corporate life for any other purpose than that, which is so specified''.

This rule in *Ashbury's case* was qualified to some extent by the House of Lords in *Attorney General v. Great Eastern Railway Co.* (1880) 5 A.C. 473 where it was held that the principle in *Ashbury's case* was one to be reasonably and not unreasonably understood and applied, and that whatever may fairly be regarded as incidental to or consequential upon the things specified in the memorandum ought not *unless expressly prohibited*, to be held by judicial construction, to be *ultra vires*.

In *London County Council v. Attorney General* (1902) A.C. 165 Lord Halsbury observed that these two cases [(1875) L.R. 7 H.L. 653 and (1880) 5 A.C. 473] do constitute the law upon the subject of interpretation of the object clause. It should be noted that where the company has a main object but general powers are also taken in the memorandum, the general powers will not be merely ancillary to the main objects of the company, if the object clause clearly declares that they are not to be so construed. *Cotman v. Brougham* 1918 A. C. 514.

*Consequences of ultra vires acts* :—The following are the consequences of an act or a contract which is *ultra vires* the powers of a company :

(1) A person borrowing money from the company under a contract which is *ultra vires* can be sued for its recovery.

(2) Where there is an *ultra vires* borrowing by the company, or it obtains delivery of property from a third party under an *ultra vires* contract, that third party has no claim against the company on the basis of the loan, but he has a right to follow his money or property, if it exists in specie, and obtain an injunction restraining the company from parting with it, provided he intervenes before the money is spent or the identity of the property is lost. *Sinclair v. Brougham* (1914) A. C. 398. If the money so borrowed is utilised for discharging the company's debts the lender would stand in the shoes of the discharged creditors and would be entitled to enforce their rights as simple contract creditors.

(3) The lender of money to a company under a contract which is *ultra vires*, has a right to make the directors personally liable, on the ground of implied warranty of authority, if their acts amount to an implied misrepresentation of fact.

(4) If the director of a company makes payment of a certain sum of money, which is *ultra vires* the company, he can be compelled by the company to refund it, but the director in his turn may claim indemnity from the person who received it knowing that it is *ultra vires*.

#### 4. Clause limiting company's liability.

The next clause in the memorandum of a company is that the liability of its members is limited, whether it is limited by shares, or by guarantee, or both. In the case of a company limited by shares this clause means that a share-holder can be called upon at any time to pay to the company only the amount, if any, remaining unpaid on his shares, e.g., if A holds 50 shares of the value of one rupee each, and he has paid calls to the extent of eight annas per share, his liability will be limited only to the unpaid amount of eight annas per share. If the entire amount of one rupee per share had been paid, his liability is at an end. There is an exception to this rule provided for in section 147. It says that if at any time the number of members of a private company is reduced to one, or in the case of a public company below seven, and yet the company carries on business for more than six months with the number so reduced, the only member in the case of private company, and the members who are less than seven in the case of public company, and who are cognisant of the fact of such reduction, shall be severally liable for the debts of that company contracted during that time. In the case of a company limited by guarantee it has already been noticed that the members' liability would be confined to an amount not exceeding the amount guaranteed. It may be noted that even though the liability of a company's members is limited, it is permissible for the memorandum to provide for the unlimited liability of any director or directors. (Sec. 71).

#### 5. Capital clause.

The Act requires that the amount of the nominal capital of the company, and the number and amount of shares into which it is divided should also be stated in the memorandum,

The Act does not impose any limits to the company's powers in this respect. The rights and privileges attached to the several classes of shares need not however be declared in the memorandum. The amount of nominal capital has to be determined having regard to the cost of starting the business, and the amount required for working it.

## 6. Association clause and subscription

We have already seen that there must be at least seven persons in the case of public company and two in the case of private company, who should sign the memorandum of association, with a view to get themselves incorporated into a company. They should also state their full names and descriptions and the number of shares taken by each of them. They should take at least one share each and their signatures must be attested at least by one witness (Secs. 6 and 9).

It is enough if there are seven or two persons, as the case may be, as signatories to the memorandum. The law does not insist on all the signatories being independent or capable of exercising independent judgment, or their being interested in the company's affairs. In England, even a minor can be a signatory to the memorandum, as a minor's contract is only voidable but not void as in our country. It is enough if each signatory takes one share. Thus if there is a public company in which there are only seven shareholders, six of them owning one share each, and all the other shares being owned by the seventh shareholder, the constitution of the company is perfectly lawful and cannot be questioned. *Salomon v. Salomon & Coy.* (1897) A. C. 22. The duties of the subscribers (signatories) of a memorandum of association are :—

- (1) to sign the articles of association;
- (2) to pay for the shares which they have subscribed;
- (3) to act as directors till the first directors are appointed ;  
and
- (4) to appoint the first directors of the company.

### Alteration of memorandum

The rules relating to change of name and place of the registered office of a company have already been noticed (*supra*).



We shall now consider the rules relating to alteration of the objects of a company. A company can alter its objects in order to attain any of the following :—

- (1) to carry on its business more economically or more efficiently ;
- (2) to attain its purpose by new or improved means ;
- (3) to enlarge or change the local area of its operations ;
- (4) to carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company ;
- (5) to restrict or abandon any of the objects specified in the memorandum ;
- (6) to sell or dispose of the whole or any part of the undertaking of the company ; and
- (7) to amalgamate with any other company or body of persons.

The alteration of the object clause can be effected by a *special resolution* of the company but it shall not take effect until and except in so far as it is *confirmed by the court* on a petition filed for the purpose. The court has to exercise its discretion in the matter of confirmation of the resolution, and it shall not be confirmed unless : (i) sufficient notice has been given to every holder of the company's debentures and to other persons whose interests will be affected by the alteration, and (ii) every creditor who is entitled to object to the alteration either gives his consent to it, or his debt has been discharged or secured to the satisfaction of the court. The court may however for special reasons dispense with notice to certain persons or classes of persons. It may also refuse to confirm the resolution when it is not unanimous, or it attempts to bring about a total change of a company's objects, or would defeat the main object of the company. The court may thus refuse to confirm the alteration, or to confirm it either wholly or in part, subject to such terms as it may impose, having regard to the rights and interests of the members of the company as well as the creditors. A certified copy of the court's order confirming the alteration, together with a printed copy of the memorandum as altered, should within 3 months from the date of the order, be filed by the company with the registrar, who shall register the same and issue a certificate certifying the registration. The said

certificate shall be conclusive evidence of the compliance with the provisions in that regard, and the altered memorandum shall come into operation thenceforth. The court is given the power to extend the time for registration beyond 3 months (Secs. 12 to 16).

*Note* :—Alterations of the memorandum in regard to the share capital, the rights of the shareholders, and converting the liability of directors from limited to unlimited, shall be considered in their appropriate places. (*infra*)

### Articles of Association.

The phrase "articles of association" also called articles, has been defined in Sec. 2 (1) as "the articles of association of a company as originally framed or as altered by special resolution, including, so far as they apply to the company, the regulations contained as the case may be in table B in the schedule annexed to Act 29 of 1857, or in table A in the first schedule annexed to the Indian Companies Act 1882, or in table A in the first schedule annexed to this Act." It is obvious that the word articles has not been defined at all. But generally speaking the articles can be defined as the internal regulations of a company. In the case of a company limited by shares, registered after this Act came into force, the articles of association may or may not be registered along with the memorandum, but in the case of a company limited by guarantee, or unlimited company, or private company, the articles must be registered. [Sec. 17 (1)]. It may be noted that a private company, even if it is limited by shares, must register its articles, because it cannot be registered as a private company unless its articles conform to the requirements of Sec. 2 (13).

**Contents of the Articles:** Articles of a company generally deal with the following topics :—

(1) The adoption of preliminary contracts; (2) The classes of shares and the number and value of shares of each class, and rights attached thereto; (3) Power to alter as well as reduce share capital; (4) The calls on shares and the issue of share certificates; (5) Transfer and transmission of shares; (6) The company's lien on the shares, and its right to sell or forfeit the shares; (7) The conduct of meetings; (8) The appointment, remuneration, qualification and rotation etc., of directors; (9) The

powers of directors to borrow, and manage the company's affairs; (10) Accounts and audits; (11) Dividends and reserves; and (13) Winding up.

A company may adopt all or any of the articles contained in table A in the First Schedule. In the case of a company limited by shares and registered after the commencement of the Act, if no articles are registered, table A shall be deemed to be the articles of the company. Even where articles are registered such of the articles in table A as are not excluded, shall so far as applicable, be deemed to be the articles of that company (Sec.18). The Amendment Act of 1936 has however laid down that a company cannot frame its articles excluding, or different from the following articles in table A, which are therefore deemed to be the articles of every company. They are regulations : 56—the mode of passing the resolution at a meeting; 66—that the instrument appointing a proxy to vote on behalf of a member shall be filed at least 72 hours before the time of meeting; 71—powers of the directors to manage the company and business; 78 to 82—rotation and re-election of directors; 95—that dividends shall be declared in general meeting and shall not exceed the amount recommended by the directors; 97—that dividends shall be paid only out of profits of the year or of any other undistributed profits; 105—inspection of the accounts and books of the company by a member other than a director; 112 to 116—service of notices on members.

*Note* :—Regulation 78 dealing with the rotation of directors, does not apply to a private company, unless it is the subsidiary company of a public company. [Sec. 17 (2).]

The object of the Legislature in applying compulsorily the above regulations of Table A to every company is that it considered the matters thereby dealt with to be of vital importance.

In the case of an unlimited company, as well as company limited by guarantee, which has a share capital, the articles will have to state the amount of share capital with which it proposes to be registered, and if it has no share capital, the articles shall state the number of members with which the company proposes to be registered, for the purpose of enabling the registrar to determine the fees payable on registration [Sec. 17 (iii)].

The articles shall: (1) be printed; (2) be divided into paragraphs and numbered consecutively; and (3) be signed by

each subscriber of the memorandum in the presence of at least one witness. (Sec. 19).

*Relation of the Articles to the Memorandum :*

The articles of a company being only a bundle of rules for the internal management of its affairs, are subordinate to and controlled by the memorandum, which is the dominant instrument. The clauses in the memorandum of association are the conditions subject to which incorporation will be granted to a company, and we have already noticed that those clauses are not easily alterable. The articles, on the other hand, can be easily altered by the members from time to time, by passing a special resolution and observing the other formalities. A company therefore enjoys great freedom in regard to the framing as well as altering its articles, subject to the following restrictions :—

(1) The articles should not violate the provisions of the Companies Act; and

(2) They should not go beyond the limits marked out by the memorandum.

The relation between the memorandum and articles has been expressed by Lord Cairns, L.C., in *Ashbury's case* (see *supra*) thus : “The memorandum is, as it were, the area beyond which the action of the company cannot go; inside that area the shareholders may make such regulations for their own government as they think fit”. Therefore the articles of a company which go beyond the memorandum are inoperative, void and incapable of ratification. Similarly articles which contravene the Companies Act e.g., by giving a power to buy company's own shares, or to pay dividends out of capital, or to deny the members' right to alter the articles as originally framed, or to deny the members' statutory right to obtain a winding up order, are clearly illegal and *ultra vires*. Though the articles cannot alter or control the memorandum or extend its objects, they can usefully be referred to for the purpose of explaining any ambiguity in the memorandum.

**Effect of Articles.**

Sec. 21 of the Companies Act lays down that the memorandum and articles when registered shall bind the company and the members thereof to the same extent as if they respectively had

been signed by each member, and contained a covenant on the part of each member, his heirs, and legal representatives, to observe all the provisions of the memorandum and of the articles, subject to the provisions of this Act. The effect of the section may now be considered in detail.

(i) *How far each member is bound to the company :*

Between the members and the company the articles constitute a statutory covenant and regulate the right and duties *inter se*. *Bradford Banking Company v. Briggs* (1886) L. R. 12 A.C. 29. In other words, every shareholder of a company, even though he is not a signatory to the articles, shall be bound by the same, as if he has entered into a contract with the company in those terms.

(ii) *How far each member is bound to other members:*

Though there is no contract in terms between individual members of the company, the articles regulate their rights *inter se*. According to some decisions the articles constitute as much a contract between one member and every other as between the company and the members. But this view was doubted in some cases on the ground that if really the articles constitute a contract between the members *inter se* it should be possible for every member of the company to restrain any member by means of an injunction, if he attempts to violate the articles, but in reality it is only the company, save in exceptional cases, that can sue for breach of the articles but not the shareholders. Thus in *Foss v. Harbottle* (1843) 2 Hare 461 it was held that the majority of shareholders is entitled to control the company and that the court will not interfere in the internal affairs of a company when there is nothing *ultra vires* the company. But the correct position was laid down by Lord Herschell in *Welton v. Saffery* (1897) A.C. 315 thus: "It is quite true that the articles constitute a contract between each member and the company and that there is *no contract in terms* between the individual members of the company, but the articles do not any the less, in my opinion, regulate their rights *inter se*."

(iii) *How far company is bound to its members :*

The articles are binding on the company in relation to its members. Thus a member can have an irregular forfeiture of shares set aside on the ground that the notice prior to forfeiture did not comply with the articles. Similarly a member can enforce

against the company the regulations relating to the issue of share certificates. It has however been held that the company is only bound to a limited extent, for the section states that the company is only bound "as if the members had signed" and the signatures of the members cannot bind the company. *Hickman v. Kent or Romney Marsh Sheep Breeders' Association* (1915) 1 Ch. 881.

(iv) *How far company or its members are bound to third parties :*

Where rights are given by the articles to a third party, or to a member otherwise than as such member (e.g. as director, solicitor etc.) such third party or member cannot enforce the articles treating them as a contract between him and the company, because he is a third party to that contract, and a stranger to a contract cannot sue. If he is to succeed he must make out a contract independent of the articles. This principle has been laid down in *Eley v. Positive Govt. Security Life Assurance Co.* (1876) 1 Ex.D. 88. In this case the company's articles provided that one X should be employed for life as a solicitor for the company, and ought not to be removed except for misconduct. After his appointment and employment for sometime, he became a shareholder. Subsequently the company terminated his employment and he sued the company for breach of contract. It was held that he could not sue as there was no contract with him. If however the contract is entered into between a member or a third party on the one hand and the company on the other, the terms contained in the articles will, in the absence of anything to the contrary, be incorporated into that contract. Thus *In Re New British Iron Co.* (1898) 1-Ch. 324 it was held that where a director accepted office on the footing of the articles, he was entitled to claim remuneration at the rate fixed therein as if it were a part of his contract with the company. This principle has considerably modified the otherwise harsh rule laid down in *Eley's* case.

### Alteration of the Articles.

According to Sec. 20 the articles of a company can be altered or added to by means of a *special resolution* subject to : (1) the provisions of the Act and (2) the conditions contained in the

memorandum. Further a company cannot even by altering its articles require an existing member to take or subscribe for more shares than the number already held by him on the date of the alteration, or in any way increase his liability as at that date to contribute to the share capital of the company, or otherwise pay money to the company. Subject to these conditions a company may alter its articles provided :

1. the altered articles do not contain anything illegal :
2. they do not constitute a fraud on the minority of the share-holders ;
3. they are made *bona fide* for the benefit of the entire company, and not even for the benefit of the majority of the shareholders. *Brown v. Abrasive Wheel Co., Ltd.* (1919) 1 Ch. 290;
4. they are not made with a view to enable the company to commit a breach of contract with third parties.

It has also been laid down in Sec. 20 that an alteration in the articles would be as valid as if originally contained in the articles, i.e., they are retrospective in effect, and the alteration will be subject to further alteration by a special resolution.

#### Constructive Notice of Memorandum and Articles :—

As the memorandum and articles are registered in the office of the registrar, they are public documents, and are open to public inspection on payment of a small fee. Further every shareholder is entitled, on payment of a small fee not exceeding one rupee, to copies of memorandum and articles of association with all alterations (Sec. 25 and 25-A). Accordingly it is settled law that anyone, whether a shareholder or an outsider having dealings with a registered company must be deemed to have notice of those two documents, which form the constitution of the company, and he will be taken not only to have read the documents but to have understood them according to their proper meaning. *Ernest v. Nicholls* (1857) 6 H.L. C. 40. The notice of those documents, which the law imputes, is called constructive notice and it is of far reaching consequence. Thus it is not open to anyone dealing with the company to plead that he is not aware of the company's powers, or of the powers of the directors.

To this doctrine of constructive notice, there is one important exception called the *doctrine of indoor management*, which is also known as the rule in *Royal British Bank v. Turquand* (1856) 6 E.N.B. 327. In this case, the company's directors issued a bond to X. They had the power to issue bonds only if authorised by a general resolution of the company. It was claimed that the bond to X was issued even though there was no such resolution. Held that X could sue on the bond and that he was entitled to assume that the required resolution had been passed, on the ground that "Persons dealing with the company are bound to read the registered documents and to see that the proposed dealing is not inconsistent therewith. But they are not bound to do more, they need not enquire into the regularity of the internal proceedings." In other words, there is a presumption in favour of the regularity of the internal or indoor management. It is based on the principle of public convenience, and also on the ground that strangers dealing with the apparent agents of a company cannot be required to do the very difficult task of proving that all internal regulations had been duly observed by the directors or the company's management.

This doctrine of indoor management is only a presumption, and would not therefore apply in the following cases :—

(1) Where the person dealing with the company was aware of the non-compliance with the internal regulations, or even where he has implied notice of the same.

(2) Where the acts complained of are not simple irregularities resulting from non-compliance with the rules of internal management, but are acts which are void; e.g., where a secretary of a company forges the signatures of two directors and issues a share certificate, a shareholder cannot rely on the doctrine of indoor management and such a certificate is absolutely void.

### Promotion and Registration of a company

*Definition of 'promoter'*: A company, being an artificial person cannot come into being unless the formalities preceding its incorporation are done by someone on its behalf. The persons who interest themselves in the formation of a company are called promoters. The word 'promoter' has not been defined in the Act, but Palmer defines it thus : "The promoters of a company



are those who form or float it, that is to say the leading spirits of the enterprise, or principal actors, for not every member of the dramatic personae, or every subordinate employed by the promoters is to be regarded as promoter." According to Cockburn C.J. a promoter is one " who undertakes to form a company with reference to a given object and to set it going, and who takes all necessary steps to accomplish that purpose." Whether a person is a promoter or not is a question of law.

The position of a promoter prior to incorporation of a company is anomalous and unenviable. He has necessarily to carry on negotiations and enter into contracts before the company comes into being; but he cannot do so as its agent because the company (principal) had not then come into being, nor can such contracts be ratified by the company after its formation, because a principal cannot ratify a contract made at a time when he was not in existence. *Kelner v. Baxter* (1866) L.R. 2 C. P. 174. (*Supra*). The company cannot be made liable even on the ground that the promoter acted as the company's trustee, because the beneficiary (the company) was then non-existent. Consequently a promoter is often made personally liable on the contracts entered into by him, on the ground of breach of warranty of authority. Owing to these difficulties it is now common to insert a clause in a contract between promoters and third parties that it is only prepared for reference, and that neither party to the contract is bound by it until a fresh contract with similar terms is entered into with the company within a limited time after it is formed. Of course, the memorandum and articles will also refer to the draft contract as one which the company should execute.

#### *Duties and Liabilities of a Promoter:*

Generally a promoter has to do the following :

- (1) Start the scheme of forming the company ;
- (2) Enter into a contract for the purchase of a business, if one is to be acquired;
- (3) Constitute a board of directors;
- (4) Retain brokers, bankers and solicitors for the company;
- (5) Get the memorandum and articles of association prepared;

- (6) Draft the prospectus;
- (7) Provide funds for registration and other preliminary expenses. (See *Supra*.)

It can thus be seen that the position occupied by a promoter is in fact one of paramount importance, but in law it is not capable of a precise definition. He is neither a trustee nor an agent for the company, as noticed above. The law therefore without attempting to define his position simply says that he stands in a fiduciary relation towards the company, and is liable to the company to make good the secret profits, if any, made by him as in the case of a director. *Erlanger v. New Sombrero Phosphate Co.* (1878) 3 A.C. 1218 and *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899) 2 Ch. 392. Lord Macnaughten describes the fiduciary position occupied by promoters thus: "They appoint themselves sole guardians and protectors of this creature of theirs, half fledged and just struggling into life bound hand and foot while yet unborn by contracts tending to their private advantage and so fashioned by its makers that it could only act by their hands and only see through their eyes.....". If a promoter therefore intends to sell his property it is incumbent upon him to make a full and frank disclosure of the profit he makes in that transaction. According to some decisions in order that such a disclosure may be valid and binding on the company, it is the duty of the promoter to provide an independent board of directors and make the disclosure to it. But Lord Lindley in *Lagunas Nitrate Company's case* observed that after the decision of the House of Lords in *Salomon v. Salomon (supra)* it is impossible to hold that there is any such duty on the promoters. If all the members of the company after it is formed are informed, by means of the articles and the prospectus, the truth of the promoter's dealings, the contract between the promoters and the company cannot be invalidated on the simple ground that the directors are only the nominees of the promoters, or persons incapable of independent judgment. The disclosure to the company must however be full and express.

Though the fiduciary relationship begins only after the company is formed, the obligation of the promoter to answer for his secret profits is from the moment he set out to form the company. A promoter may become accountable in one of two ways :  
(1) If a promoter *acquires property for the company* and makes a

profit in the transaction, he is liable to account to the company, because he occupies the position of an agent and all the rules of agency apply; (2) If the promoter *acquires property with the object of selling it to the company*, which he intends to form, he does not at the time of his purchase occupy the position of an agent, because there was no principal (company) in existence. Nevertheless as he stands in fiduciary relationship he has to make at the time of sale to the company a full and frank disclosure of the profit he is making in the transaction. If on the other hand the promoter *acquires property for himself, and at a later date forms a company, and resells the property to it*, he cannot be deemed to be either an agent or a trustee, and cannot be compelled to either disclose or make over his profits.

Where a promoter sells property without making the disclosure in cases (1) and (2) above, the contract, if it is unfavourable to the company, can be rescinded by it, provided restitution is possible. If restitution is not possible, the company can recover by way of damages, the profits which the promoter has made. It may be noted that a promoter will also be liable for any misrepresentations made by him in the prospectus. (See *infra*.) If the company is in the course of winding up, the promoter can be made liable for breach of trust or misfeasance, by means of misfeasance summons. (See *infra*).

*Note*:—A promoter is entitled to remuneration for his services and he is often paid in the shape of commission, or allotment of deferred or founder's shares, which are fully paid up. This consideration received by the promoter must be disclosed in the prospectus.

#### *Formalities for registration of a company:*

Before a company can be registered by the registrar of joint stock companies the following documents must be filed:—

- (1) The memorandum of association, duly stamped;
- (2) The articles of association (unless dispensed with), duly stamped;
- (3) A statement of the nominal capital;
- (4) A statutory declaration under Sec. 24 (2) by an advocate, or director, or manager, or secretary, of the company engaged in its formation, that all the requirements of the Act in respect of

registration and the precedent and incidental matters, have been complied with.

*Note* :—These documents are sufficient for the registration of a private company, but in the case of a public company the following additional documents should also be filed.

(5) A list of persons who have consented to be directors.

(6) If the first directors are appointed by the articles (i) the written consent of the directors duly signed by them to act as such, and (ii) an undertaking in writing signed by each director to take and pay for his qualification shares, if any, unless he has already taken as a subscriber of the memorandum, a number of shares not less than the qualification shares.

On filing the documents and paying the required fee for registration, the registrar shall retain and register them, and certify that the company is duly incorporated from the date mentioned in the certificate of incorporation issued by him. From that date the subscribers of the memorandum together with such other persons as may from time to time become members of the company, shall be a body corporate, by the name contained in the memorandum, capable of exercising forthwith all the functions of an incorporated company and having perpetual succession and a common seal, but with such liability of the members in the event of its being wound up as is mentioned in the Act. (Secs. 22 and 23).-

#### *Certificate of incorporation:*

The certificate of incorporation is conclusive evidence that all the requirements of the Act in respect of registration etc., have been complied with, and that the association is a company authorised to be registered, and that it has been duly registered under the Act [Sec. 24 (1)]. It is only conclusive evidence so far as the ministerial acts are concerned, but not as to (i) whether the company is one which could be lawfully registered under the Companies Act but not under some other Act, e.g., Trade Unions Act, or (ii) the legality of the company's objects. *Bowman v. Secular Society*, 1917 A.C. 406.

#### Restrictions on Commencement of Business

Even after obtaining the certificate of incorporation, some other formalities have to be satisfied before certain companies can commence business. Sec. 103 lays down that *companies other*

*than private companies having a share capital* shall not be entitled to commence business or exercise any of the borrowing powers, unless the following conditions are satisfied :

1. Shares which are held subject to the payment of cash have been allotted at least to the extent of the minimum subscription.

2. Every director has paid to the company on the shares taken by him, for which he is liable to pay cash, a sum equal to what is payable on the shares offered to the public on application and allotment.

3. A declaration by the secretary or one of the directors that the aforesaid conditions have been complied with has been filed with the registrar.

4. If the company does not issue a prospectus, at least a statement in lieu of the prospectus must have been filed with the registrar.

If all the above conditions are satisfied, the registrar shall issue a certificate which will authorise the company to commence business, and which will be conclusive evidence that the company is so entitled. Non-compliance with the aforesaid provisions would make every person responsible for the same liable to fine. This section as stated at the outset does not apply to private companies, and the provisions relating to shares do not apply to companies limited by guarantee and not having a share capital. Any contract made by a company before the issue of the certificate of incorporation is only provisional, and shall not be binding on the company until that date.

## PROSPECTUS

*Definition* :—The word prospectus has been defined in Sec. 2 (14) as “any prospectus, notice, circular, advertisement or other invitation, offering to the public for subscription or purchase any shares or debentures of a company but shall not include any advertisement which shows on the face of it that a formal prospectus has been prepared and filed”. Generally speaking, a prospectus is usually understood to mean a circular published by the promoters after the formation of a company, to induce the public to take shares in it. That being so, the promoters who issue a prospectus would often be inclined to make it as attractive as

possible, and if they are dishonest, may even make mis-statements for that purpose. From the stand point of the investing public however it is very essential that the statements contained in a prospectus should be absolutely true. Otherwise, they would be induced to take shares on the strength of false and misleading statements and later on come to grief. Consequently the Legislature has incorporated stringent provisions noted *infra*, to make the statements in a prospectus absolutely true. The document, whether called a prospectus or not, if it is issued for the purpose of inviting the public to subscribe for its shares, must according to the Act satisfy all the formalities of a prospectus. If the object of a document is however only to circulate among a small circle of friends and it is not a document offering shares to the public for subscription, it cannot be deemed to be a prospectus. Similarly a prospectus is not "issued" if it is shown to one person privately and not as a member of the public. *Nash v. Lynde* (1929) A.C. 158.

We have already noticed that except in the case of a private company, every other company must before it commences business file with the registrar a prospectus or a statement in lieu of prospectus. Otherwise it cannot allot any of its shares or debentures. Every prospectus issued by or on behalf of the company shall be dated, and a copy of such prospectus signed by every person who is named therein as a director or a proposed director of the company shall be filed for registration before it can be issued for publication. Every prospectus shall state on the face of it that a copy of the same has been filed for registration. Issuing a prospectus without its being filed with the registrar is made punishable. (Sec. 92).

A statement in lieu of prospectus should be signed by every person named therein as a director or proposed director of the company, and it should contain the particulars set out in the form marked I in the II Schedule. (Sec. 98). It will be seen that its contents are to a large extent the same as in a prospectus.

#### *Contents of a Prospectus :—*

Sec. 93 lays down that every prospectus must state the following :—

1. The contents of the memorandum with the names, description and addresses of the signatories and the number of founders' or deferred shares, if any, and the nature and extent of interest of the holders of the deferred shares

in the property and the profit of the company, and the number of redeemable preference shares intended to be issued with the date and proposed method of redemption.

2. The number of shares (if any) fixed by the articles as the qualification of a director, and the remuneration of a director.

3. Names, description and addresses of directors, and of the proposed managers and managing agents, if any, and any provisions in the articles or in any contract as to the appointment of and remuneration to the managers or managing agents.

4. The minimum subscription on which directors may proceed to allotment and the amount payable on application and allotment on each share, and in the case of a second or subsequent offer of shares, the amount offered for subscription on each of the previous allotments made within the 2 preceding years, and the amount actually allotted, and paid on the shares so allotted. The number and amount of shares and debentures which within the 2 preceding years have been issued or agreed to be issued as fully or partly paid up, otherwise than in cash, and the consideration for which they were so issued.

5. Where the shares or debentures are underwritten, the names of the underwriters and the opinion of the directors that they are sufficiently solvent to discharge the underwriting obligation.

6. The names and addresses of the vendors of the property, purchased or to be purchased by the company, which has to be paid out of the proceeds of the issue offered to the public and the manner in which it is intended to be paid *i.e.*, either in cash, shares or debentures.

7. If the property in the preceding clause has been sold within the last two years, the amount paid by the purchaser for the same should be stated and if that property is a going concern, the profits realised each year for a period of not less than 3 years preceding the prospectus must be stated.

8. The amount paid as purchase money in cash, shares or debentures for property purchased by it, specifying the amount paid for goodwill.

9. The amount paid or payable within the 2 preceding years to underwriters and the amount paid to the managing agents.

10. The amount or estimated amount of preliminary expenses.

11. The amount payable or paid within the two preceding years to any promoter, and the consideration for any such payment.

12. The dates of and parties to every material contract, including contracts relating to the acquisition of property to which clause 6 applies. This rule does not apply to contracts in the ordinary course of business or contracts made more than 2 years prior to the issue of prospectus except a contract appointing or fixing remuneration of a managing director or a managing agent.

13. The names and addresses of the company's auditors, full particulars of the nature and extent of the interest of every director in the promotion of the company or in the property proposed to be acquired by the company, and if the director is a partner in a firm, the nature and extent of interest of that firm should be stated. Further, a statement of all sums paid or agreed to be

paid to him or to a firm of which he is a partner in cash, or shares, or otherwise, in order to induce him to become or to qualify him to become a director, or for services rendered by him or by the firm in the promotion or formation of the company should be stated.

14. Where the company has shares of more than one class, the right of voting, the rights in respect of capital and dividends attached to the several classes of shares should be stated.

15. Where the articles of the company impose any restrictions on the rights of members to attend, speak or vote at meetings of the company or the right to transfer shares, or upon the directors of the company, in respect of their powers of management, the nature and extent of those restrictions should be mentioned.

16. Where any part of the sums required for minimum subscription is to be provided out of sources other than the share capital, the particulars of that amount and the sources should be mentioned.

17. In addition to the above particulars sub-ss. (1-A), and (1-B) of S. 93 require that a prospectus issued by a company, which has been carrying on business prior to its issue, should furnish particulars regarding the profits during the 3 preceding financial years, the rates of dividends issued on the several classes of shares, and the source from which the dividends have been paid, and if the proceeds or any part of it is to be applied for the purchase of any business, the report of the accountant who shall be named in the prospectus, shall also be filed. In the case of statement referred in clause 7 above and the statement just now referred to, the profits of the company or business should also state clearly the trading results etc.

In the case of a prospectus published in a newspaper for advertisement the contents of the memorandum, the signatories and the number of shares subscribed for by them need not be specified. This section does not apply to a notice or circular issued to the existing members or debenture-holders inviting them to subscribe for more shares and debentures. The particulars relating to memorandum, the qualification, remuneration and interest of directors, the names, descriptions and addresses of directors and of managers, and the amount of preliminary expenses need not be stated in the case of a prospectus issued one year after the company became entitled to commence business.

Sec. 93 is some times sought to be evaded by directors of companies by allotting the whole issue of shares to a syndicate or company called an "*issuing house*", which in its turn would offer the shares for sale to the public by means of a prospectus. With a view to remedy this, Sec. 98-A now lays down that the document by which the offer for sale to the public is made by the issuing house, shall be deemed a prospectus, and that all the rules relating to a



prospectus are applicable to the same. The section will *prima facie* apply when the prospectus is issued by the issuing house within 6 months after allotment or agreement to allot in its favour, or the whole consideration for the allotment has not been received by the company. The prospectus issued by the issuing house should also state (1) the net amount received by the company for the shares and debentures allotted, and (2) a place and time at which a contract with the issuing house can be inspected. The persons who issue this prospectus are made liable as if they are directors (98-A).

The object with which the Legislature insists upon the prospectus giving all the above details is two fold : (i) to disclose the objects and the capital of the company—for which purpose the contents of the memorandum are required to be incorporated in a prospectus (ii) to disclose to the public how far the directors are prepared to repose confidence in the company, and whether they are floating the company only for their selfish ends, or for the general benefit of the shareholders—for which purpose the other particulars in the prospectus are required to be given. The Legislature is so anxious to protect a share-holder against himself, that it has enacted that any condition requiring an applicant for shares to waive compliance with the terms of Sec. 93 is void, and that a copy of the prospectus should be supplied along with every application for shares or debentures. (Sec. 96). Sec. 97 also makes every person who issues a prospectus contravening Sec. 93 liable to fine, and Sec. 282 makes a person responsible for wilfully making a false statement in a prospectus, liable to imprisonment for a period of 3 years.

### Consequences of mis-statements in a prospectus.

As a person applying for shares inspects the prospectus the statements therein become the basis of the contract between him and the company and if any of them are false the shareholder would have certain rights. These rights are available against the company as well as against the directors and promoters. The aggrieved company is also given certain rights against the promoters and directors.

I. *Rights of allottee of shares against the company :—*

A contract to take shares is governed by the same rules as other contracts, and if it is induced on account of any misstatements in the prospectus, whether fraudulent or innocent, the contract becomes voidable, and the shareholder can rescind the contract and get his name struck off the register. It may however, be noted that, even if the misstatement complained of is fraudulent, the shareholder cannot retain the shares, and at the same time claim damages against the company, for the law does not permit him to approbate and reprobate at the same time. *Houldsworth v. City of Glasgow Bank* (1880) 5 A. C. 317. But this right of rescission will only be available if : (i) the statements complained of are statements of fact, are untrue, are material, and are relied upon by the shareholders while applying for the shares ; (ii) the application for rescission is made, within a reasonable time and (iii) before proceedings for winding up have been commenced.

II. *Rights of shareholders against promoters and directors :—*  
This may be considered under the following heads.

(1) *Neglect of Statutory duty :*

The Act does not state what rights a shareholder would have against a director or promoter for not furnishing all the particulars in the prospectus as required by S. 93, but it is clear that in as much as it is a statutory duty, the persons issuing a prospectus would, in the event of non-compliance with Sec. 93, be liable in damages to the shareholder on the ground of *neglect of statutory duty*. This right will be available even if the shareholder cannot sue for rescission of his contract or have his name removed from the register.

Sec. 97 (2) lays down that a director or other person responsible for the issue of prospectus cannot be made liable for non-compliance with Sec. 93 if he is able to prove that :

(i) as regards a matter not disclosed, he was not cognisant thereof, or

(ii) the non-compliance with Sec. 93 arose from an honest mistake of fact on his part, or

(iii) the non-compliance is in respect of matters which the court considers immaterial and should be excused. In the case of non-compliance with clause (n) of Sec. 93 (i.e. failure

to state the interest of every director, or of the firm of which he is a partner, in the property of the company), no director or promoter can be made liable unless it is proved that he had knowledge of the matters not disclosed.

(2) *Liability under Sec. 100 :*

We have already noticed that an exception to the rule in *Derry v. Peek* (see supra p. 53) has been recognised by Sec. 100 of the Companies Act. It lays down that directors, promoters or other persons responsible for issuing a prospectus shall be liable to pay compensation to all persons who subscribe for shares or debentures and suffer loss, on account of any misleading or untrue statements therein, even if those statements are simply innocent and not fraudulent misrepresentations. A promoter or director can escape liability to the shareholder under this section only if he is able to establish : (i) that with respect to statements not made on the authority of an expert or of public document, he had reasonable grounds to believe those statements to be true; (ii) that the statements, if made on the authority of an expert or from a report or valuation of an expert, it fairly represented the said opinion of the expert or his valuation; (iii) if the statement is one purporting to be the statement of an official person or an extract from an official document, that it correctly represented the same; or unless it is proved (iv) that having consented to become a director he withdrew the same before the prospectus was issued, and that it was issued without his authority ; or (v) that the prospectus was issued without his knowledge and that he gave reasonable public notice of the same soon after he became aware of it ; or (vi) that after the issue of the prospectus and before allotment he withdrew his consent and gave reasonable public notice of the withdrawal with reasons therefor, after he became aware of any misleading or untrue statements.

*Note :—*Sub-sections (3) and (4) of Sec. 100 also provide for the right of indemnity of one director against other directors, and contribution amongst directors *inter se*, subject to certain conditions.

(3) *Liability for deceit :—*

Sec. 93 clause 5 lays down that nothing in the section shall limit or diminish any liability which any person may incur under the general law. It follows that if a prospectus contains fraudulent statements the allottee of shares can claim damages in an

*action for deceit.* This remedy as we have noticed will be available even if his right of rescission is lost, or even if the company goes into liquidation.

### III. *Rights of the Company against the Promoters.*

We have already noticed that the promoters occupy a fiduciary position towards the company, and that they must make a full and frank disclosure in the prospectus of all the contracts entered into by them with the company, with regard to the sale of their property, their remuneration etc. If any of those statements are not true, or a frank disclosure of the same has not been made to the company, it can set aside that contract. If the mis-statement or non-disclosure is fraudulent, the company can claim damages against the promoters in an action for deceit. If the company is not able to rescind the contract, because of restitution not being possible, or the misstatement complained of not being fraudulent, the company will be without any remedy against the promoters.

Consequences of mis-statements in a statement in lieu of prospectus:—

The Act does not deal with this question but the following principles can be gathered from decisions:

(1) If the shareholder has entered into a contract to purchase shares on the strength of a statement in lieu of prospectus, it becomes the basis of the contract, and as such if there is any material misstatement in it, he will be entitled as against the company to rescind the contract.

(2) In as much as Sec. 98 lays down that certain particulars should be mentioned in a statement in lieu of prospectus, non-compliance with the section would enable the shareholders to claim damages against the promoters for neglect of the statutory duty.

(3) If the misstatements in it are fraudulent, the shareholder would be entitled to claim damages for deceit.

*Note :—*Sec. 99 lays down that a company shall not at any time vary the terms of a contract referred to in the prospectus or statement in lieu, of prospectus, except by a resolution by the company in general meeting.

## Shareholders.

A shareholder of a company is also called its member, and in the case of a company limited by shares the terms member and shareholder are synonymous. Sec. 30 enacts that (i) the subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration shall be entered as members in its register of members; and (ii) every other person who agrees to become a member of a company and whose name is entered in its register of members shall be a member of the company. Thus according to the Act a person may become a member of a company in one of two ways :

(i) by signing the memorandum of association, or

(ii) by taking shares and being entered on the register of members.

A person may also become a member in the following cases:

(iii) by taking a transfer of shares from a member and being placed on the register, or

(iv) by registration as heir to a deceased member, or

(v) by allowing his name to be on the register of members or by otherwise representing himself or allowing himself to be represented as a member.

(1) *Membership by signing the memorandum.*

Sec. 30 clearly lays down that the subscribers of the memorandum shall be deemed to be members and therefore the moment the company is incorporated they occupy the position of members, even though there is no allotment of shares or registration of their names. A subscriber of the memorandum cannot rescind his contract on the ground of fraud or misrepresentation by the promoters nor is he entitled to any other relief against the company, *In re Metal Constituents Ltd.* (Lord Lurgan's case) (1902) 1 Ch. 707. A subscriber cannot revoke his contract even before the registration of the company.

(2) *Membership by allotment.*

The most usual way in which a person becomes a member of a company is by obtaining an allotment of shares. The intending shareholder applies to a company for shares, which amounts to an offer. If the company allots all or some of the shares, it is

an acceptance, and when the letter of allotment is duly posted the contract becomes complete. (*supra* page 21).

According to Sec. 30 the name of the allottee has to be placed on the register of members, before he can be clothed with the rights of a member. *Nicol's case*, 29 Ch. D. 421. Therefore even though a person has been allotted shares, if his name has not been entered on the register of members, his remedy is a suit for specific performance of the contract. If the allottee's name has not been placed on the register of members by reason of some fraud or without sufficient cause, the allottee is given the right to have the summary remedy of having the register rectified by an application under Sec. 38. He may also have that remedy by way of a regular suit. This right to have the register rectified can be exercised even when the company is being wound up. (Sec. 184). Under Sec. 40 the register of members is *prima facie* evidence of any matters directed to be inserted therein by the Act, so that if a person's name is wrongly shown as a member (though he has never agreed to be one) he cannot be made liable as a member. On the other hand if he allows his name to remain on the register, with full knowledge and assent, he will be made liable as a member.

Where the application for shares is accompanied by a condition precedent e.g., that the shareholder should be appointed as manager or secretary of the company, but the company allots the shares without appointing him, the allotment is ineffective, and even though the allottee has not revoked his application he cannot be made liable as member as the condition precedent to become a member has not been fulfilled by the company. *In re Roger's case*, *Harrison's case* (1868) L.R. 3 Ch. App. 633. If the condition attached to the application is a collateral condition, or a condition subsequent, the applicant will be made liable as a member on allotment of shares, even though the condition has not been fulfilled. In such a case his only remedy is to claim damages against the company.

### (3) *Membership by transfer:—*

Section 28 lays down that the shares of the company are transferable in a manner provided by the articles, and it therefore follows that a person can become a member by taking a transfer of shares and being placed on the register.

(4) *Membership by succession:—*

By operation of law i.e., by death or insolvency of a member his legal representative or the official assignee, as the case may be, can become a member of the company.

(5) *Membership by estoppel : —*

It is a general rule of law that if a person holds himself out as a member, he is estopped from denying it, even though he is not really one.

*Who may become a member:—*

The Act does not lay down any special qualification or capacity for becoming a member of a company. Any person who can enter into a contract can become a member. In particular it may be noted that one company may become a member of another company, provided the memorandum of the former company authorises it to do so. A person who lends money to the company on a mortgage of its shares, as well as a person who takes shares in the name of a fictitious person, may become liable as members.

In England a minor's contract being only voidable, he may take shares and become liable as a member, subject to his repudiation on becoming a major. But in India all contracts with a minor being void, he cannot contract to be a member of a company. If in ignorance of his minority the company allots shares and places his name on the register the minor as well as the company, on having knowledge of the applicant's minority, can repudiate the allotment and have his name removed from the register. The minor can repudiate his liability even after his attaining majority because a minor is not estopped from pleading his real age. *Sadiq Ali v. Jaikishori* 55 M.L.J. (88 P.C.) If however the minor continues to receive dividends after attaining majority, and intentionally induces the company to believe that he is a member and pay him dividends in that belief, he would be estopped by his conduct while a person *sui juris* from denying his liability as a shareholder.

*Note:—*According to Sec. 33 of the Act a company cannot take notice of any trust express, implied or constructive. From this it follows that it is only the trustees or the executors, as the case may be, that can be treated as members of the company, and not the beneficial owners.

*Liability of members :—*

We have already seen that a member is liable : (i) in the case of a company limited by shares to pay the whole nominal amount due on his shares in cash, (ii) in the case of a company limited by guarantee to pay an amount not exceeding the amount guaranteed, and (iii) in the case of an unlimited company to pay the entire debt of the company. A share-holder in the absence of a contract to the contrary has to pay cash towards unpaid share capital, which means that the transaction should be such as would, in an action at law for calls, support the plea of payment. *Larocque v. Beauchemin* (1897) A.C. 358. Shares may also be issued for consideration other than cash e.g., as consideration for the sale of business, or other property sold to the company. They are sometimes allotted as fully paid, in consideration of services performed by the promoters before the company is incorporated. But in no event can the company agree that the liability on shares shall be wiped out in consideration of future services. The liability to pay the entire nominal value of the share is not discharged until it is actually paid up, either at the time of allotment or subsequently. If before the entire amount is paid up, the company goes into liquidation, the balance still due on the shares shall be collected by the official liquidator from the member, who shall, from the moment of winding up, be called a *contributory*. Even after a transfer of a shares a shareholder will not be completely free from liability, because under Sec. 156 it is not only the present members of the company (who are called the A list of contributories), but also persons who transferred their shares within one year before winding up, (who are called the B list of contributories), that will be liable to the liquidator. It may be noted that a contributory in the B list will be liable only if (i) on the date of winding up debts which were incurred while he was a member exist, and (ii) the contributories in the A list cannot satisfy the contributions required by them in respect of those shares (Sec. 156).

*Termination of member's liability:—*

A person may cease to be liable as a member in the following cases :—

1. by a transfer of shares, more than one year prior to winding up ;
2. by a valid forfeiture or surrender of shares ;



3. by sale of the shares by the company in exercise of its lien ;
4. by death—when the shares would be transmitted to the person representing the estate of the deceased ;
5. by winding up of the company—when a member gets transformed into a contributory ;
6. by a rescission of the contract of membership and removal from the register of members.

#### Register of Members

According to Sec. 31 every company is required to maintain in one or more books a register called the register of members containing : (i) the names and addresses etc., of the members, the shares held by them, with their numbers, and the amount paid or treated as paid on those shares; (ii) the date on which each person was entered in the register as a member; and (iii) the date on which he ceased to be a member. We have already noticed that the said register is *prima facie* evidence of the matters required to be inserted therein by the Act (Sec. 40). Sec. 41 provides for the maintenance of a branch register of members in the United Kingdom, in the case of a company having share capital, and Sec. 42 enumerates the rules governing the maintenance of the said register.

In addition to the register of members Sec. 31 enacts that every company having more than 50 members shall maintain an index of members, unless the register itself is in such a form as to constitute an index of the names of the members of the company. Secs. 36 and 37 lay down that the register of members commencing from the date of registration of the company shall be kept at the registered office of the company and enact rules facilitating inspection and obtaining copies of the register on payment of a moderate fee.

It follows that the register of members is a very important document determining the rights and liabilities of members, and we have seen that Secs. 38 and 184 provide for rectifying the register and bringing it in conformity with the real state of affairs, by means of a petition filed, during the time the company is a going concern, or even during liquidation. Sec. 39 requires that every rectification of the register made by the Court shall be communicated to the registrar of joint stock companies within a fortnight from the date of the order, for being filed.

### Annual List and Summary

Sec. 32 requires that every company having a share capital should within 18 months from the date of its incorporation, and once a year thereafter prepare a document called annual list of members and summary. It should contain (1) list of all persons who are members of the company on the day of the first meeting of the year, and of persons who have ceased to be members since the date of the last return or in the case of the first return since the date of incorporation of the company, (2) the names, addresses and occupations of all past and present members therein mentioned, and the number of shares held by each of the existing members at the date of the last return, the shares transferred since then or in the case of the first return since the incorporation of the company and, the dates of the registration of the transfers, and (3) a summary distinguishing between shares issued for cash, and shares issued as fully or partly paid up otherwise than in cash, and specifying the following particulars :

- (i) the amount of share capital of the company and the number of shares into which it is divided ;
- (ii) the number of shares taken since the commencement of the company ;
- (iii) the amount called up on each share ;
- (iv) the total amount of calls received ;
- (v) the total amount of calls unpaid ;
- (vi) the total amount paid by way of underwriting commission, or discount on shares or debentures since the date of last return ;
- (vii) the total amount of shares or stock for which share warrants are outstanding on the date of the return ;
- (viii) the total amount of share warrants issued and surrendered since the last return ;
- (ix) the number of shares or the amount of stock comprised in each share warrant ;
- (x) names and addresses etc., of the directors of the company, and of the managers and managing agents, and the changes in the personnel since last return ; and
- (xi) the total amount of debts due from the company in respect of all mortgages and ; charges.

The list and summary should be contained in a separate part of the register of members, and should be completed within 21 days after the first ordinary general meeting of the year. A copy of the same signed by the director, manager or secretary duly

verified should be filed with the registrar forthwith. A private company is required to send along with this annual return and summary a certificate signed by a director or other officer of the company that it has not issued an invitation to the public to subscribe for the shares and that its members do not exceed 50. A default in compliance with the provisions of this section entails a liability on the company and every officer of the company to pay fine.

### Capital of a Company

The word 'capital' is used in the Act, in more than one context. The share capital of a company may be any one of the following kinds :—

(1) *Nominal or authorised capital i.e.*, the nominal value of the shares which a company is authorised to issue by its memorandum. We have already noticed that the clause relating to capital is an important clause in the memorandum and that it should also be stated each year in the annual summary.

(2) *Issued capital i.e.*, the nominal value of shares actually offered by the company for subscription.

(3) *Subscribed capital i.e.*, the whole of the issued capital or a portion of it, which is taken up by the public out of the issued capital.

(4) *Paid up or called capital i.e.*, the amount actually paid up or credited as paid up on the subscriber's shares, the balance due on them being called *uncalled capital*.

*Illustration* :—Thus, if a company is authorised to issue a capital of Rs. 10,000 divided into 10,000 shares of one rupee each and if only 5,000 shares are actually issued and all of them are subscribed, and on application and allotment a sum of annas 8 per share is paid—Rs. 10,000 represents the nominal capital of the company, and Rs. 5,000 represents the issued as well as subscribed capital, and Rs. 2,500 will be the uncalled capital. One rupee represents the nominal amount or value of each share, and annas 8 which remains to be paid is called the unpaid amount on the value of each share.

Sec. 101 (3) deals with the restrictions as to allotment and lays down that the amount payable on each share shall not be less than 5% of its nominal amount, and that unless the minimum subscription fixed by the articles is realised by the amount

payable on application, the directors cannot proceed to allot the shares. On allotment of shares the directors can collect a further sum of money out of the unpaid share capital.

There is yet another classification of capital into (i) fixed capital and (ii) circulating capital.

(1) *Fixed capital i.e.*, property acquired and intended for being retained and employed in the business of the company with a view to profit *e.g.*, buildings, machinery etc.

(2) *Circulating capital i.e.*, property acquired or produced with a view to resale at a profit *e.g.*, ordinary merchandise, or articles manufactured by the company itself for sale.

The word capital is also used in connection with (i) Capital assets, (ii) Reserve capital, and (iii) Debenture capital.

(i) *Capital assets i.e.*, the actual property of the company.

(ii) *Reserve capital* : A limited company may by special resolution determine that any portion of its share capital which has not been called up, shall not be capable of being called up, except in the event of and for the purpose of the company being wound up, and thereupon that portion of its share capital shall not be capable of being called up except in the event and for the purposes aforesaid. (Sec. 69). The capital so reserved is called *reserve capital* and the liability on the shares so reserved is called *reserve liability*. Reserve capital cannot be converted into ordinary capital without leave of the court and it cannot be dealt with or charged by the directors. *Bartlett v. Mayfair Property Co.* (1898) 2 Ch. 28.

(iii) *Debenture Capital* : It is usual, but incorrect, to speak of money borrowed by a company by issuing debentures as debenture capital. This is not capital in any sense, because borrowed money can never be capital. It is generally secured by a charge on the capital assets. Even if that money is borrowed for replacing the assets, or purchasing property for the company, which would become a capital asset, it retains its original character as a debt due from the company.

### Classes of Shares

All the shares of a company need not be of the same amount, nor need they have attached to them the same rights. The rights attaching to particular classes of shares may be determined

either by the memorandum or by the articles. Unless the memorandum expressly provides otherwise, a company can at any time alter its articles and issue shares with preferred rights. *Andrews v. Gas Meter Coy.* (1897) 1 Ch. 361. Where the rights attached to several classes of shares were set out in the memorandum it was held that they were unalterable. *Ashbury v. Watson.* (1885) 30 Ch. D. 376.

The several classes of shares are : (i) *preference shares*, (ii) *ordinary shares* (iii) *founders' or deferred shares* (iv) *redeemable preference shares*, and (v) *bonus shares*.

1. *Preference shares*:—They may be one of two kinds: (i) preferential as to dividend, and (ii) preferential as to capital. Shares preferential as to dividend may again be one of two kinds : (i) those which are cumulative, and (ii) those which are non-cumulative.

A *cumulative preferential share, preferential as to dividend*, will be entitled to a fixed rate per cent before any dividend is paid on other classes of shares, and if in any year, the profits are not sufficient to declare that dividend, they ought to be made good out of the profits of the subsequent years. In the case of *non-cumulative preferential shares, preferential as to dividend*, the fixed rate per cent will have to be paid before other classes of shares, but if in any year the profits are not sufficient to declare the dividend, they cannot be paid out of the dividends of subsequent years. Unless there are words to the contrary in the articles, the presumption is that preferential shares are cumulative.

*Preferential shareholders, preferential as to capital*, would in the event of winding up be paid out of the assets remaining after all creditors and expenses of liquidation have been paid, in priority to ordinary share-holders. If there is no preference as to capital, shares preferential as to dividend will rank *pari passu* with ordinary shares for the purpose of return of capital.

2. *Ordinary shares* :—Generally the bulk of shares in a company will be ordinary shares. Ordinary share-holders take the surplus profits after paying the fixed dividends on preference shares, if any. They may also be entitled to a proportion of the profits after the deferred share-holders have received a fixed portion of the dividend, or they may also participate in a fixed proportion with the deferred shares, depending upon the terms of the articles.

3. *Founders' or Deferred shares* :—Founders' or deferred shares are generally limited in number, and of small nominal value, and are issued fully paid to the original vendors, or promoters for their services, or to underwriters towards their commission. They rank for a dividend after the other two classes of shares have received the dividends to which they are entitled, and generally take the whole or a very large proportion of the surplus profits. These deferred shares are also called, *management shares*. The contract by which the founders' shares are issued must be filed with registrar and the number of such shares has to be stated in the prospectus or statement in lieu of prospectus (Sec. 93).

4. *Redeemable preference shares* :

They are dealt with in Sec. 105-B. A company, if so authorised by its articles, may issue preference shares which are liable to be redeemed when they are fully paid up. Such shares can be redeemed out of the profits of the company which would otherwise be available for dividend, or out of the proceeds of a fresh issue of shares made for the purpose of redemption. Where such shares are redeemed otherwise than out of the proceeds of a fresh issue, the company must transfer out of the profits a sum to the reserve fund to be called "the capital redemption reserve fund", equal to the amount applied in redeeming those shares, and the provisions relating to the reduction of the share capital of a company will apply to that fund, as if it were paid up share capital of the company. Where such shares are redeemed out of the proceeds of a fresh issue the premium, if any, payable on redemption must be provided for out of the profits of the company before the shares are redeemed. Further the particulars regarding the redeemable preference shares should be included in every balance sheet of the company and default in this respect is made punishable with fine. A company is also given the power while redeeming any of its preference shares to issue shares up to the nominal amount of the shares redeemed or to be redeemed, as if they had never been issued.

5. *Bonus shares* :

A company after declaring a dividend may instead of paying it in cash issue to its members a number of new shares of that value, and utilise the amount of dividend due to the shareholder

for fully paying up those shares. The fully paid up shares so issued are called bonus shares.

### Stock.

When shares have been fully paid up they can be converted into stock, and stock may be defined as "a set of fully paid up shares put together in a bundle." Fully paid up shares can be converted into stock, and stock reconverted into fully paid up shares of any denomination by a *resolution of the company in general meeting*, provided it is authorised by the articles. The advantage of converting fully paid up shares into stock is this. Stock is not divided into equal parts and the divisions are not numbered, while it is not so with regard to shares. Thus a person can hold Rs. 10-5-4 of stock though the denomination of each share is Rs. 100/. *Morrice v. Aylmer*. L.R. 7 H.L. 717. Further stock may either be registered or unregistered. If it is registered, a register of stockholders is kept and a stock certificate similar to a share certificate will be issued, and the transfer of stock and the dividends payable thereon will be similar to the case of shares (Sec. 52). If the stock is unregistered, then stock warrants will be issued to the holders and they are transferable by delivery. Stock-holders are members of a company and can vote at its meetings. But where stock is unregistered, the stock-holders must prove their right to the stock before voting.

### Alteration of capital.

A company limited by shares may alter the conditions of its memorandum whenever necessary, but such a power must be given by its articles, and if not so given, the articles must be amended before that power can be exercised. The capital of a company can be altered in the following ways :—

#### 1. *Increase of share capital:*

It may be done by the issue of new shares of such amount as it thinks expedient. [Sec. 50 (1) (a)]. Generally a company's capital is increased only when it has issued all its authorised capital and requires more for increasing its business *e.g.*, the capital of a company may be increased from Rs. 20,000/- in 2,000 ordinary shares of Rs. 10/- each, by the addition of Rs. 30,000/- in 30,000. 6% preference shares of Re. 1/- each or Rs. 30,000 in 30,000 ordinary

shares of one rupee each. Thus new capital may consist of preference, ordinary, or deferred shares, provided there is nothing in the memorandum to prevent it. A company may increase its capital even if it has not issued all its capital. It may be noted that when directors decide to increase the capital of a company by the issue of further shares such shares shall be offered to the members in proportion to their existing shares (irrespective of class) held by each member. Such offer shall be made by a notice specifying the time within which the offer should be accepted and after its expiration the directors can, if the offer has not been accepted by the members, dispose of the new shares as they think most beneficial to the company (Sec. 105-C).

2. *Consolidation and sub-division of capital:*

A company may consolidate or subdivide its share capital e.g., every 20 one rupee shares may be consolidated into one share of 20 rupees, or one share of Rs. 10 may be sub-divided into 10 shares of one rupee each, but the proportion of the amounts paid and unpaid on the shares should remain the same even after sub-division. One advantage in sub-division is that preferential rights may be attached to one part of each old share e.g., each old share can be sub-divided into say, one preferred and one deferred share. [Sec. 50 (1) (b)].

3. *Conversion of paid up shares into stock:*

We have already noticed that fully paid up shares can be converted into stock and *vice versa*. [Sec. 50 (c)].

4. *Cancellation of shares:*

A company may cancel its shares which are not subscribed or agreed to be subscribed by any person, and diminish the amount of its share capital by the shares so cancelled. It may be noted that a cancellation of shares in this mode does not amount to a reduction of share capital. [Secs. 50 (e) and (3)].

*Note :—*A company limited by shares may alter the share capital in any of the aforesaid ways only if so authorised by its articles. Further, those powers can be exercised only by the company in general meeting, and in the case of sub-division or cancellation of shares the company shall file with the registrar notice of the exercise of such power within 15 days from the exercise thereof.



### Re-organisation of capital.

A company limited by shares can reorganise its share capital, by consolidation of shares of different classes, or by the division of its shares into shares of different classes, or by alteration the rights of holders of different classes of shares. This can be done by a resolution of shareholders majority in number representing  $\frac{3}{4}$  in value of the members or class of members whose rights would be affected thereby, and sanctioned by the court. An order of the court confirming the said resolution should be filed with registrar [Sec. 153 (1), (2) and (6).]

### Variation of shareholder's rights.

The rights attached to the different classes of shares may be varied if provision is made to that effect in the memorandum or the articles. Generally it is provided that they should not be altered without the consent of a specified proportion of the holders of that particular class or the sanction of a resolution passed at the separate meeting of that class of share-holders. Now Sec. 66 (A) with a view to ensure that the rights of a particular class of share-holders may not be altered to their prejudice without their consent, provides that not less than 10% of the sharers of the class affected by the variation who have not consented to the variation may apply to the court to have the variation cancelled. Thereupon the variation will not be operative unless it is confirmed by the court which may disallow or confirm the variation having regard to the prejudice it would cause to the applicants.

### Reduction of share capital.

A company can reduce its share capital if so authorised by its articles. If such a power is not given by the articles they should be amended first so as to confer such a power on the company. Even if such a power is given in the memorandum it is not enough, and the articles must also provide for the same. Where the company has lost some of its capital it may be very difficult for it to pay dividends and with a view to avoid this difficulty, power is given to write off lost capital and to pay dividends without regard to such loss. A reduction of company's capital is generally prohibited. On this principle it was held in *Trevor v. Whitworth*,

(1887) 12 A.C. 409. that it was illegal for a company to buy its own shares. But in order to provide for special cases Sec. 55 permits reduction under certain circumstances, and Sec. 54-A lays down that a company limited by shares shall not have the power to buy its own shares, or the shares of a public company except in the manner provided for by Secs. 55 to 66. Sec. 54-A also forbids every public company from directly or indirectly granting a loan or guaranteeing, or securing, or otherwise rendering, any financial assistance for the purpose of or in connection with a purchase made or to be made by any person of any shares in the company. A violation of the section is also made punishable. Section 55 permits reduction of a company's share capital in the following ways :—

1. By extinguishing or reducing the liability of members in respect of uncalled share capital.
2. By writing off capital, which is lost, or unrepresented by available assets.
3. By paying off paid up capital which is in excess of the wants of the company.

This reduction of capital can be done only by a *special resolution confirmed by the court*. One class of reduction is called *all-round reduction*, according to which the lost capital is to be paid off or cancelled or reduced in the same percentage in respect of each share, even if they be of different classes. *Prima facie* a reduction of capital should be an all-round one, but it is open to a company to pass a special resolution reducing the capital of only one class of shares and not the rest, although both classes rank evenly as regards capital, or the company may pay off wholly or in part only some of the shareholders, although they are entitled to rank *pari passu*. Either form of reduction can be confirmed by the court but it will not do so, if the reduction is unfair to a particular class of shareholders. *Barrow Haematite Steel Co., In re*, (1900) 2 Ch. 846.

*Procedure to obtain sanction of the court:*

A company intending to reduce its capital has to first of all pass a resolution to that effect and it is called the *resolution for reducing share capital*. The company should then apply to the court for its confirmation. If the reduction involves a return of capital, or a reduction of liability for uncalled capital, or in

any other case if the court so directs, the court holds an enquiry as to the debts and liabilities of the company by hearing the objections of creditors, and it would then settle a list of creditors so entitled to object, and for that purpose ascertain the names of those creditors and the nature and amount of their debts or claims, and publish notices fixing a period within which the creditor can object to the correctness of the same. After settling the list of creditors and hearing their objections, if the court is satisfied that every creditor has either : (i) given his consent to the reduction, or (ii) his debt or claim has been discharged, or (iii) secured, the court may make an order confirming the reduction. After the court orders the confirmation of the resolution the company will have to add the words "*and reduced*" as part of its name for such period as the court directs. The object of adding those words is to inform the public that the capital noted in the memorandum has been reduced. The court may in the case of creditors whose names are on the list and whose debt or claim is not discharged and who do not consent to the reduction, dispense with their consent, on the company securing the payment of their debt.

*Note:—*On the resolution being confirmed by the court a certified copy of the court's order and the minute of the resolution should be filed with the registrar for registration. The registrar shall then issue a certificate which shall be conclusive evidence that all the formalities relating to reduction have been complied with. Until registration, the resolution cannot be given effect to. Sec. 63 deals with the liability of members in respect of reduced shares, and it lays down that the liability of such members past or present, will not exceed the difference between the amount paid up in respect of the shares and the amount to which the shares are finally reduced as the result of reduction of capital.

### Shares and their allotment.

*Definition :* Sec. 2 (16) defines a share thus: "share means share in the share capital of the company, and includes stock, when a distinction between stock and shares is expressed or implied." This is really no definition at all. A share however

has been defined as "the interest of a shareholder in the company measured by a sum of money for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se*". *Borland Trustees v. Steel Brothers* (1901) 1 Ch. 279. In other words a share is a right to receive certain proportion of the profits of the company, and of the capital of the company when it is wound up. The shares are moveable property, transferable in a manner provided by the articles of the company. They are all numbered and are identified by these numbers (Sec. 28). The shares are allotted on an application by the prospective shareholder. (see *supra*). Allotment is generally made by a resolution of the board of directors. Even though the shares are allotted, until the allottee's name is placed on the register, he does not become a member (*supra*). In the case of every public company shares cannot be allotted unless the prospectus or a statement in lieu of prospectus is filed with the registrar (Sec. 98). The other conditions which must be satisfied before a company can allot shares are to be found in Sec. 101. It lays down that no allotment shall be made of any share capital of a company, offered to the public for subscription unless : (1) the amount stated in the prospectus as the minimum amount (called minimum subscription) has been subscribed, and (2) a sum of at least 5% thereof has been paid to or received in cash by the company.

#### *Minimum subscription.*

The items which should be provided for in fixing the minimum subscription are :

(i) the purchase price of any property purchased or to be purchased which is to be defrayed in whole or in part out of the proceeds of the issue;

(ii) any preliminary expenses payable by the company, and any commission payable to any person in consideration of his agreeing to subscribe for, or of his procuring or agreeing to procure subscriptions for any shares in the company;

(iii) the repayment of any moneys borrowed by the company in respect of any of the foregoing matters ; and

(iv) working capital.

The moneys received from the applicant for shares should be kept in a scheduled bank, until the certificate to commence business has been obtained under Sec. 103. If the company is not able to realise the minimum subscription within 180 days after the first issue of the prospectus, all moneys received from the applicants for shares shall be returned forthwith without interest. If any such money is not so repaid within 190 days after the issue of the prospectus, the directors of the company shall be jointly and severally liable to repay that amount with interest at the rate of 7 per cent. per annum. A director however shall not be liable if he proves that the loss of money was not due to any misconduct or negligence on his part. These provisions relating to minimum subscription were incorporated by Sec. 101 as several companies in the past had proceeded to allotment even without the minimum subscription being subscribed for, and caused loss to companies as well as the investing public. Now the minimum subscription cannot be fixed according to the sweet will and pleasure of the directors and in any event the amount, paid by the allottees should not be touched, until the minimum subscription has been subscribed. These provisions cannot be waived even with the consent of the applicant for shares, and their violation is also made punishable.

*Note :—*These provisions do not apply to any allotment of shares subsequent to the first allotment, nor to a private company. A private company can therefore proceed to allotment if what is fixed as minimum subscription in its articles has been subscribed, and 5% of the nominal amount of each share has been paid.

*Effect of irregular allotment:*

An allotment of shares made in contravention of Secs. 98 and 101, is voidable at the instance of the applicant, within one month after the holding of the company's statutory meeting, or one month after the date of allotment, (if the allotment is after the statutory meeting or where the company need not hold a statutory meeting) but not later. This right of avoidance can be exercised even in the case of a company which is being wound up. Further the aggrieved shareholder as well as the company are given the right to claim compensation from any director who has knowingly contravened or permitted the contravention of Secs. 98 and 101, for any loss, damages or costs suffered by them, provided the pro-

ceedings are taken within 2 years from the date of allotment. Further every such director can be made liable for misfeasance under Sec. 235.

*Note :—*Even after the share capital to the extent of minimum suscription has been subscribed, a public company can only proceed to allotment of shares, but cannot commence business or exercise borrowing powers unless the provisions laid down in Sec. 103 have been complied with (*supra*).

*Return as to allotments:*

Where a company makes an allotment of its shares it is required to file with the registrar what is called "return as to allotments". Sec. 104 lays down that a return as to allotment should contain the following particulars :—

(i) the number and nominal amount of shares comprised in the allotment, and

(ii) the names and addresses of the allottees, and

(iii) the amount paid or payable on each share. If the shares are allotted as fully or partly paid up, the contract constituting the title of the allottee to the allotment together with any contract of sale or for services on other consideration in respect of which the allotment was made, should be produced for inspection and a copy of the same should be filed with the registrar. Non-compliance with this section is made punishable.

*Note :—*This section does apply to the issue and allotment of shares which had been forfeited.

### Commission and discount.

*Under-writing agreement :* It is "an agreement whereby previously to an offer of a company's shares to the public for subscription, some person undertakes, in consideration of a commission, to take the whole or a portion of such (if any) of the offered shares as may not be subscribed for by the public". An under-writing agreement is made with a view to secure that the whole issue of shares shall be taken up notwithstanding unforeseen events like 'out-break of war' or hostile propaganda against the company etc. An under-writing agreement may be for under-writing shares or debentures. The consideration for underwriting is a small commission to the underwriters on all the shares offered to the public.

*Brokerage* : It is different from an underwriting agreement. A broker is employed by a company for placing shares *i.e.*, for finding another person to take shares, in consideration of a commission called brokerage to be paid to him. Therefore a broker does not take or agree to take shares himself as an underwriter. Thus if a company agrees to pay a commission of 2% to an under-writer it may amount to issuing shares at a discount, but if a company promises to pay 2% to a professional broker, stock broker, or banker, it will be a payment of a brokerage commission, and not issue or sale of shares at a discount. Hence payment of commission to brokers has been always recognised by law subject to certain conditions, but payment of commission to under-writers has been discouraged. The amendment Act of 1936 has incorporated Sec. 105 which recognises the payment of brokerage, as well as under-writing commission subject to certain conditions, and Sec. 105-A which gives to the company a restricted power to issue shares at a discount.

*Company's power to pay brokerage and underwriting commission:* Sec. 105 enacts that a commission can be paid to a person subscribing or agreeing to subscribe or procuring or agreeing to procure subscriptions for any shares in a company if: (i) the payment of the commission is authorised by the articles, (ii) it does not exceed the amount or rate so authorised, and (iii) the rate of commission is disclosed in the prospectus or statement in lieu of prospectus. Except as aforesaid and as provided in Sec. 105-A the company's capital is not permitted to be used either directly or indirectly for payment of any commission either (i) by way of brokerage or (ii) for under-writing. Sub-sec. 3 of Sec. 105 enacts that the power of a company to pay brokerage to vendors or promoters of companies for services rendered (*i.e.*, other than subscribing or agreeing to procure subscribers) is not hereby affected.

*Company's power to issue shares at a discount :*

Sec. 105-A lays down that it shall be lawful for a company to issue at a discount, shares of a class already issued, provided (i) the issue of shares at a discount is authorised by a resolution passed in general meeting of the company and sanctioned by the court, (ii) the resolution specifies the maximum rate of discount that can be allowed, which in any event should not exceed 10%

(iii) at least one year has elapsed since the date on which the company was entitled to commence business and (iv) the shares to be issued at a discount are issued within six months after the date on which the issue is sanctioned by the court or within such extended time as the court may allow.

Every prospectus relating to the issue of shares, and balance sheet issued subsequent to the said issue of shares, must contain the particulars of the discount allowed or of so much of the discount as has not been written off at the date of the issue of the document in question. Non-compliance with these provisions is made punishable with fine.

### Share certificate.

A share certificate is a document issued by a company under its seal specifying any shares held by a member. It is *prima facie* evidence, but not conclusive evidence of title of the member to the shares covered by it. (Sec. 29). Sec. 108 requires that every company shall within 3 months after allotment of any of its shares, debentures, or debenture stock, and within 3 months after the registration of the transfer of any of them, have ready for delivery the certificates of all such shares, debentures or debenture stock which was allotted or transferred, unless the conditions of their issue otherwise provide. The effect of a share certificate has been held by decisions to be as follows :—(1) If a company issues a certificate declaring that a certain person is the registered holder of a certain number of shares, the company is estopped from subsequently denying the title of that member to those shares; (2) If the certificate shows that the shares are fully paid the company cannot afterwards contend that they are not fully paid. *Burkinshaw v. Nicolls* (1878) 3 A.C. 1004. In other words the company is estopped with regard to title as well as to payment. But a company is not liable on share certificates in which the secretary has forged the signatures of the directors. *Ruben v. Great Fingall consolidated*, (1906) A.C. 439.

### Transfer of shares.

Section 28 recognises the power of a shareholder to transfer his shares. But certain restrictions can be imposed by the articles of association on a member's right to transfer shares though that right cannot be altogether denied. Sec. 34 of the Act lays



down the procedure to be followed for transferring shares. It enacts that the application for transfer may be either by the transferor or by the transferee, and where the application is by the transferor in respect of partly paid shares the company is required to give 2 week's notice of the application to the transferee and if he does not object his name would be entered in the register of members in the same manner as if the application is made by him. It also requires that a proper instrument of transfer duly stamped and executed by the transferor and transferee should be delivered along with the share scrip (certificate). The company should in the event of its refusal to register the transfer of shares, send to transferee and transferor the notice of refusal. This section does not prejudice the power of a company under its articles to refuse to register the transfer of any shares. The articles may for instance give the directors power to refuse to register the transfer, when the calls are in arrears, or where the company has a lien on the shares and the shares to be transferred are not fully paid, but the articles can in no event absolutely prohibit the transfer of shares. When the directors in the exercise of their discretion refuse to register a transfer, the court will not interfere, unless it is proved that the discretion was not exercised *bona fide*. Art. 19 of Table A, it may be noted, deals with the procedure relating to transfer of shares. It has already been noticed that a transfer is not complete, until it is registered by the company, and the transferee's name is entered in the register.

A contract for the sale of shares does not impliedly bind the vendor to procure the registration of the transfer. His duty ends the moment he hands over the instrument of transfer duly executed along with the share certificate, but until registration the transferor will be a trustee of the shares, for the transferee. If the buyer wants to protect himself against the contingency of the transfer not being registered by the company, he must insist on the clause "*with registration guaranteed.*"

A transfer of shares may be: (i) *cum dividend* or (ii) *ex-dividend*. The transfer is *cum dividend* when according to the agreement between the parties the transferee is entitled to the dividend already declared or about to be declared at the time of the transfer. The transfer is *ex-dividend* if it is the transferor that is entitled to those dividends. If there is no agreement in

respect of dividends the transferee will be entitled to all the dividends declared after the agreement to transfer shares and the transferor will be entitled to all dividends declared prior to transfer, though a part of it is payable after the transfer.

*Blank Transfer:* When the shareholder sells or mortgages his share, he commonly signs and hands over what is called a blank transfer *i.e.*, a transfer signed by the transferor but with a blank for the name of the transferee, so that the purchaser or the transferee may fill up the blank and perfect the security by getting himself registered. A person taking a blank transfer gets an equitable interest in the shares and he may sell them on failure of the mortgagor to repay the debt within a reasonable time.

*Forged Transfers:* If a company acts upon a transfer deed which is forged, it incurs serious liability, for by reason of mere registration of the transfer the real owner does not lose his title to his shares, and he can make the company liable for his loss, and also require the company to restore his name to the register. It may be noted that a member likewise cannot rely on a forged transfer because the rule that a company is estopped from denying the title of a shareholder to whom a share certificate has been given, does not apply in the case of a certificate obtained on the strength of a forged transfer.

*Transfer during winding up :* Every transfer of shares after the commencement of winding up, which is compulsory or under supervision, shall unless the court otherwise directs, be void [Sec. 227 (2)].

*Certification of Transfer :* When shares are transferred, the transferee will have to hand over to the company, the transferor's share certificate along with the instrument of transfer. If the transferor is transferring only some of the shares covered by his certificate and not all of them, the transferor files the certificate with the company, and on his request the company's secretary issues two certificates, one in favour of the transferee for the shares transferred, and another in favour of the transferor for his remaining shares, and endorses on the transfer that the original certificate in respect of the entire number of shares had been lodged with the company. That is called *certification of transfer*. By certification, the company does not warrant the title of the transferor to the shares, but it is only regarded as a representation

that the transferor had produced such documents as on the face of them showed a title in the transferor to make the transfer.

### Share warrants

In the case of fully paid up shares or stock, a company limited by shares may, if authorized by its articles, issue under its seal, a warrant stating that the bearer of the warrant is entitled to the shares, or stock therein specified, and may provide by coupons or otherwise for the payment of future dividends on the shares or stock therein specified. Such a warrant is called a *share warrant*, and the shares then become transferable by delivery. Such share warrants are negotiable instruments. The bearer of the share warrant shall subject to the articles be entitled on surrendering it for cancellation, to have his name entered as a member in the register of members. The company shall be liable for any loss incurred by any person by reason of its so registering the name of the bearer of a share warrant without the warrant being surrendered and cancelled. The bearer of a share warrant is deemed to be a member of the company, except that he shall not be qualified on the strength of the shares or stock specified therein to become a director of the company, in cases where such a qualification is required by the articles. On the issue of a share warrant, the company shall strike out of its register of members the name of the member already entered as holding the shares or stock specified in the warrant, as if he had ceased to be a member, and in its stead enter (i) the fact of issue of the warrant, (ii) the number of shares etc. covered by the warrant, and (iii) the date of the warrant (Secs. 43 to 47).

*Note* :—A share warrant cannot be issued by a private company.

### Calls

A shareholder is liable to pay the amount payable on the shares, i.e., the nominal value of the shares, unless they are issued as fully or partly paid up. The amount of share capital is rarely demanded at once, but it is generally demanded in certain instalments e.g. if the nominal value of a share is Rs. 100, the company may require Rs. 10 to be paid on application, Rs. 20 on allotment, another Rs. 20 in 3 month's time and the balance of Rs. 50 when called for. Then the first two payments, and

according to one view also the third payment, are not calls, because they are not amounts called by directors, but payable according to the articles. If the company wishes to have the whole or a portion of the balance of Rs. 50, the directors make a *call* or *calls*. A call, as Lord Lindley puts it, is used to denote both a demand for money, and also the sum demanded. The articles of a company provide as to how and by whom the calls are to be made but call money must be paid in cash.

Sec. 49 of the Act lays down that a company, if so authorised by its articles, may (i) make arrangements on the issue of shares for a difference between the shareholders in the amounts and times of payment of calls on their shares, (ii) accept from any member who assents thereto, the whole or any part of the amount remaining unpaid on any shares held by him though no part of that amount has been called up. According to Sec. 21 (2) the nature of liability to pay calls is a debt due from the member to the company. Though Sec. 49 (1) empowers the directors to provide for a difference in the amount and time of payment of calls in respect of the shares, there is an implied equality as between members, and the directors ought not, except in special cases, make calls only on one class of shareholders. Regulations 12 to 17 of Table A deal with calls on shares. The Act does not say when or by whom the uncalled capital is to be called up by the company when it is a going concern. These matters are regulated by the articles of association. Regulation 71 of Table A which is now compulsorily made applicable to all companies, lays down that a call must be made by the entire body of directors. The resolution by which the directors decide upon a call must state: (i) the amount of the call, (ii) the time when call is to be made, (iii) the place, and (iv) the person on whom the call is to be made, and a notice of the call must be served on the shareholders. The power to make a call is of a fiduciary character, and as such the directors must act strictly in accordance with the articles and for the benefit of the company. Otherwise the call would be invalid. If the directors decide that a call is necessary, the court will not interfere with it unless the call is outside the scope of the memorandum, or unless it is established that the call is not made *bona fide* in the general interests of the company but made for their private advantage, e.g. to pay their

sitting fees. *Sykes case* (1872) 13 E.Q. 255. We have already noticed that calls may be paid in advance, if authorised by the articles, and in such a case interest can be paid on the advance calls even if there are no profits. The calls paid in advance cannot be repaid while the company is a going concern, but on winding up it is repayable with interest after the costs of winding up and ordinary creditors have been paid, but before any return of the capital of the company is made to any class of shareholders. While the company is a going concern, a shareholder may set off a debt presently due to him from the company against a call that has been made, but when the company is being wound up, that is not possible.

*Note :—*The liquidators are not bound to observe the articles in the matter of making the calls, because while a company is a going concern the liability of the members to pay the unpaid call amount is contractual, but once the company goes into liquidation the liability becomes one under law to contribute to the assets of the company.

### Lien on shares

The articles generally provide that a company shall have the first lien on the shares of each member for his debts and liabilities to the company. (vide articles 9 to 11, table A). In the absence of such a provision a company has no lien on its member's shares. The effect of lien is to create an equitable charge in favour of the company. A lien may be created not only in respect of unpaid calls, but also for other debts due from the members in any capacity whatsoever, and it attaches not only to the shares but also to the dividends payable thereon. A purchaser or transferee of shares will also be bound by the lien. If so authorised by the articles, the company's lien can be enforced by sale of the shares, and the purchaser shall then be registered as transferee. It may be noted that a lien cannot be enforced by forfeiture of shares, even where the articles so provide. A lien can be claimed by a third party who discharges the debt due to the company and averts their sale, because the third party in that case would be subrogated to the company's rights. If a member mortgages his shares to a third party the mortgagee's rights would be subject to the lien only for any debt already due to the company from the member. If the mortgagee gives

notice to the company of his charge, he can claim priority over the company's lien in respect of debts contracted subsequent to the said notice. *Bradford Banking Co. v. Briggs (supra)*.

### Forfeiture of Shares

The articles of a company generally contain a provision for forfeiture of shares by the directors, for non-payment of call money due on the shares. (vide articles 24 to 30 of table A). This power to forfeit shares is not an inherent right of a company, and it can therefore be exercised only where it is conferred by the articles. The Act does not deal specifically with forfeiture of shares, but it recognises the right of a company to forfeit shares in Secs. 32-G and 104 (4). The consequences of forfeiture are that a shareholder whose shares have been forfeited ceases to be a member of the company and cannot, unless the articles otherwise provide, be made liable for the call money remaining unpaid on them, nor can he be made liable as a contributory in the event of the company being wound up. Further the shares forfeited by a company become the company's property and can again be re-issued. A forfeiture already effected can however be cancelled by the directors on such terms as they think fit.

The right of forfeiture of shares can be exercised only for realising unpaid call money and not for recovery of any other debts due from the shareholders. A power to forfeit shares for realising debts other than call money, even if conferred by the articles, is *ultra vires* and void. *Hopkinson v. Mortimer, Harley and Co.*, (1917) 1 Ch. 646. The reason is that a lien being an equitable mortgage, a clause to enforce it by forfeiture of shares would amount to a clog on the equity of redemption, and hence void. Forfeiture of shares, it may be noted, is the only case in which a company is allowed to reduce its share capital without the sanction of the court. Since it is an extraordinary right vested in the directors, it must be exercised like all other fiduciary powers, for the benefit of the company. A forfeiture which is collusive, or made for the purpose of favouring some director or member, is therefore invalid. Further the directors can exercise that power only after observing the articles in that regard. Any violation of the articles shall render the forfeiture void and liable to be set aside by the Court. Where the forfeiture is sought to be made for a purpose not

memorandum and articles. In the case of a trading company the power to borrow is implied and need not be given by the memorandum, but in the case of a non-trading company, it has no power to borrow much less charge its property, unless such a power is conferred by the memorandum. A company can alter its memorandum under Sec. 12, if necessary, and obtain the power to borrow. The consequences that would result on account of a borrowing which is *ultra vires* the company or its directors, has already been noticed, (*supra*). The power to borrow also carries with it the power to charge property as security for re-payment of the loan. The borrowing powers of a trading company have to be vested in some person or persons, and generally it is the directors that are empowered to exercise that power.

A company borrowing money may give any one or more of the following securities :—

(1) A legal mortgage of specific part of its immoveable property *e.g.*, by creating a mortgage on its free hold or leasehold property. (2) An equitable mortgage by deposit of title deeds. (3) A mortgage of chattels or moveables. (4) Issuing bonds. (5) A charge on its uncalled capital. (6) Promissory notes and bills of exchange. (7) A charge on book debts. (8) A floating charge on the whole undertaking of the company. (9) A charge securing any issue of debentures or debenture stock.

We shall now consider some of the important securities that can be offered by a company.

### Charge on uncalled capital

The power to create a charge on the uncalled capital of a company can be exercised only if it has been conferred by the memorandum or articles. A company may charge its uncalled capital by including the same in the security by using unambiguous language to that effect. It was held that an instrument creating a charge on the "assets, property, and rights" of a company would include a charge on its uncalled capital, but an instrument creating "charge on its company's property" would not include it. A charge on uncalled capital can be enforced by the appointment of a receiver. It may be noted that reserve capital cannot however be charged.

### Debentures

The word 'debenture' has been defined in Sec. 2 (4) as including 'debenture stock'. Palmer defines debenture as an instrument under seal evidencing a deed, the essence of it being the admission of indebtedness. But generally speaking a debenture is a written promise by the company, sealed with the company's seal, to repay money advanced and interest according to the terms laid down in the document. Because companies may have to borrow large sums of money which would not easily be found, the debt which is secured is, split up is into small units, in respect of each of which the company issues what is known as a debenture. The debentures are issued in a manner similar to shares by means of a prospectus inviting applications, and the money also is payable in instalments—on application, allotment, and on specified dates. Debentures issued by a company may be : (i) *ordinary or naked i.e.*, debt is not secured, or (ii) *mortgage debentures i.e.*, the debt is secured by a charge on the whole or part of company's property. Mortgage debentures may be either: (i) with *floating charge*, or (ii) with *fixed charge*. A debenture may be either payable (a) *to bearer*, or (b) *to registered holder*. In the former case it is transferable by delivery and is a negotiable instrument, while in the latter case it can only be transferred by registration in the company's books. A contract to take debentures can be enforced by means of specific performance.

### Debenture stock

Debenture stock is of the same character as debentures, but instead of each debenture being for a fixed amount the capital sum lent to the company is treated as a single stock usually secured by a trust deed, giving a mortgage or charge on certain property of the company in favour of the trustees. The difficulty in distinguishing debenture from debenture stock is due to the fact that the word debenture is loosely used to refer both to the instrument securing the debt, as well as the debt itself. The point of similarity between a debenture and debenture stock is that in the case of a debenture there is a debt due from the company and evidenced by a document called *debenture*, while in the case of a debenture stock also there is a debt due from the company (called



*debenture stock*) and evidenced by a document called *debenture stock certificate*. The points of difference between them are the same as in the case of shares and stock. Firstly a debenture stock is consolidated into one mass of debt, and each lender is entitled only to a certificate entitling him to a certain portion of the aggregate loan, while in the case of a debenture each lender will have a separate mortgage or bond called debenture. Secondly a debenture of a series can only be transferred as a whole, while debenture stock can be transferred even in fractional parts.

*Contents of a debenture:*

The terms generally found in the body of a debenture are: (i) that the debenture is one of a series of a certain limited number of similar debentures for a like amount; (ii) that all the debentures of the series rank *pari passu* as a first or other charge; (iii) that such charge will be either a floating or a fixed charge; (iv) that the company will not create any charge ranking in priority to, or *pari passu* with the debentures of the series. '*Pari passu*' means that every one of the debentures in the series will be paid rateably in the event of security not being sufficient to satisfy the whole debt. Where the words *pari passu* are not used, the debentures rank in priority according to the date of issue, and where they are all issued on the same day according to their serial number. It is not possible for a company to issue another series of debentures to rank *pari passu* with an earlier series, unless such a power has been expressly given in the debentures of that series.

Debentures are generally issued subject to certain conditions which will be endorsed on the back of those instruments. They generally deal with: (i) the *pari passu* clause; (ii) keeping and inspecting of registers of debenture holders; (iii) recognition of only the registered holders; (iv) provision relating to transfer of debentures; (v) power of the company to give notice to pay off; (vi) money to become payable immediately, if the company makes default in payment of interest or goes into liquidation; (vii) power of a specified portion of debenture holders to appoint a receiver; (viii) provision as to meetings of debenture holders.

*Advantage of debentures having trust deed:*

We have already noticed that some times debentures are secured by executing a deed of trust. Such a deed conveys the

company's property to the trustees, declaring a trust for the benefit of the debenture-holders and creating a floating charge over the other properties and giving the company the right to retain possession until it makes default in payment of interest etc. It also contains provisions relating to convening of meetings of debenture holders, remuneration of trustees etc., and the respective rights of the debenture holders. The advantages in having such a deed of trust are : (i) if the company makes default, the trustees will be ready to take the necessary steps, instead of individual debenture holders being obliged to take the initiative; (ii) The trustees may be given the power to sell and realise the security even without the help of the court; (iii) As the legal estate will be vested in the trustees the company cannot subsequently create a legal mortgage having priority; (iv) The company may also be required by means of the terms of the deed to insure the security.

*Irredeemable or perpetual debentures :*

The debentures issued by a company may be redeemable, or irredeemable, and Sec. 126 lays down that a debenture shall not be invalid only by reason that they are irredeemable, or redeemable only on the happening of a contingency, or on the expiration of a period however long. An irredeemable debenture is not really irredeemable. It only means that the holder of the debentures cannot demand payment, but the company may redeem at its option. It may also be noted that even irredeemable debentures become immediately payable on the company going into liquidation.

*Contract to take debentures :*

Unlike other contracts to borrow money, a contract with a company to take up and pay for any debentures of a company may be enforced by specific performance. The rule that shares cannot be issued at a discount does not apply to debentures, because debenture capital is not capital at all. So debentures can be issued at a discount and the interest on debentures can be lawfully paid out of capital. A prospectus issued for the purpose of inviting the public to take debentures of a company, it may be noted, is a prospectus within the meaning of Sec. 2 (14) and all the rules relating to contents of a prospectus offering shares and the liability for misstatements therein apply to it.

*Re-issue of redeemable debentures*:—Where a company has redeemed any debentures previously issued, the company has, unless its articles or conditions of issue are to the contrary, or unless the debentures have been redeemed in pursuance of any obligation of the company so to do, (not being an obligation enforceable only by the person to whom the redeemed debentures are issued or his assigns), power to keep the debentures alive and to re-issue the debentures either by re-issuing the same debentures, or by issuing other debentures in their place. Where with the object of keeping the debentures alive for the purpose of re-issue they have been transferred to a nominee of the company, a transfer from that nominee shall be deemed to be a re-issue. The effect of re-issuing redeemed debentures is to entitle their holders to the same rights and priorities, as if the debentures have never been previously issued. The power to issue redeemed debentures otherwise possessed by a company under the terms of debentures, is not affected by the section (Sec. 127).

*Floating charge*:—The expression floating charge means that the assets of a company are charged with the payment of a debt, but the company may deal with any of its assets in the ordinary course of business until the charge becomes a fixed charge. The characteristics of floating charge are: (1) it is a charge on a class of assets present and future; (2) that class of assets is one which in the ordinary course of business would be changing from time to time; and (3) it is contemplated that until some steps are taken, the company shall carry on its business in the usual way. The charge becomes fixed when: (i) the money becomes payable according to the conditions of the debenture, and (ii) the debenture holder takes some steps for enforcing his security. The charge is then said to become *crystalised* or *fixed*.

Generally the money due under a debenture becomes payable under its conditions in the following cases: (i) if the company makes default in payment of interest and the principal money is itself demanded by notice by the registered holder; (ii) by execution being levied against any property of the company and its not being paid within the time stipulated in the debenture in that behalf; (iii) a resolution is passed for the winding up of the company; (iv) a receiver is appointed by a competent court in respect of the

company's property. In order that the charge may become crystallised the money must have become payable in one of such ways and the debenture holder must have taken some steps to enforce it e.g., for the appointment of a receiver through or out of court.

Lord Macnaghten points out the distinction between *a fixed or specific charge* and *a floating charge* thus: "a specific charge, I think, is one that without more fastens on ascertained and specific property or property capable of being ascertained and defined; a floating charge, on the other hand is ambulatory, shifting in its nature, hovering over and, so to speak, floating with the property which it is intended to affect until some event occurs or some act is done which causes it to settle and fasten on the subject of the charge within its reach and grasp". Thus unless otherwise agreed, even after creating a floating charge, a company can create a specific charge or mortgage on its property having priority over the floating charge, or assign the rents of its lands, which are subject to the charge, or even sell away the whole undertaking, if it is authorised by the memorandum to do so. It may be noted that a person obtaining such a charge is liable to be postponed to the following persons: (i) a landlord who distrains for rent; (ii) a creditor who obtains a garnishee order; (iii) a judgment creditor who gets the goods attached and sold; and (iv) debts which under Sec. 230 of the Act are entitled to preferential payment in the event of the company being wound up (Sec. 129).

Sec. 109 (2) now provides that every person acquiring the property of a company or any share or interest therein which is subject to a mortgage or charge, shall be deemed to have notice of the same from the date of registration provided the mortgage or charge has been registered. Therefore if a debenture creating a floating charge provides that the company cannot create mortgages in priority to, or *pari passu* with the debentures which are issued, subsequent mortgagees cannot claim any priority because they shall be deemed to have notice of the earlier floating charge. According to S. 233 a floating charge created within 3 months prior to the commencement of the winding up shall, unless it is proved that immediately after the creation of the charge the company was solvent, be invalid, except to the extent of cash paid to the company under it.

### Remedies of debenture holders :—

1. For the purpose of realising the money and enforcing his security, a debenture holder may avail himself of any of the following remedies :

- (1) He may sue on behalf of himself as well as other debenture holders to obtain payment, or to enforce his security by sale. In such an action, (called *debenture holder's action*) the court appoints a receiver, and if necessary a manager, and declares the debentures to be a charge on the assets of the company, and directs enquiries as to who are debenture holders, and orders the sale of the property ;
- (2) He may appoint a receiver if the conditions empower him to do so ;
- (3) He may apply to the court for foreclosure, which may extend even to the uncalled capital of the company ;
- (4) He may present a petition for winding up the company ;
- (5) He may have the property sold, if so authorised by the debenture ;
- (6) If the company is insolvent and his security is insufficient, he may value his security and prove for the balance of the debt, or give up the security altogether and prove for the whole debt.

#### *Receiver :*

We have already seen that a debenture holder may himself appoint a receiver if he is expressly authorised by the debentures to do so. A court may also appoint a receiver in a debenture holder's action: (i) if the principal money has become due, or (ii) if the company is wound up, or (iii) if the security is in jeopardy e.g., where a creditor has levied execution, or a judgment debt remains unsatisfied, or a company closes its business. In our country the Court has power under the Civil Procedure Code to appoint a receiver in a pending action whenever it is of opinion that it is just and necessary to do so, and hence its power is not confined only to the above instances. The Court may also appoint a manager if it is necessary to do so. On the appointment of a receiver the assets of the company become specifically charged

in favour of the debenture-holders and the company's power to deal with its business ceases. A manager is generally appointed to carry on a company's business for the purpose of selling it as a going concern. In an action by a debenture holder the court therefore generally appoints a receiver to be a receiver as well as manager.

*Note:—*A receiver appointed by Court is an agent of the court and he becomes liable personally, though he will be indemnified out of the assets of the company. Where the debenture holder himself appoints a receiver under the powers given by the debenture, he is the agent of the debenture holder, who will therefore be liable on his contracts, unless the debenture itself provides that such a receiver shall be the agent of the company.

*Book debts.*—A company can also borrow on the security of its book debts i.e., those which arise in the business, and which would ordinarily be entered in the accounts of a company, whether actually so entered or not. A mortgage, charge, or a floating charge can be created even on future book debts.

*Information regarding registration of mortgages, charges etc:—*

Sec. 109 requires that a mortgage, or charge created by a company ;

- (1) for the purpose of securing any issue of debentures, or
- (2) on uncalled share capital, or
- (3) on any immoveable property, or
- (4) on any book debts, or
- (5) on moveable property of a company, except stock-in-trade, which does not amount to a pledge, or
- (6) a floating charge on the undertaking or property of the company.

Shall be registered with the registrar giving the particulars of the mortgage or charge, and that the instrument by which it is created should be filed within 21 days after its creation. A mortgage, charge, or pledge not falling within the above descriptions need not be registered. Sec. 109-A requires similar particulars to be filed in respect of properties acquired by a company, which are subject to a mortgage or charge of any of the

above kinds. Sec. 110 provides for an alternative mode of registration, by filing certain particulars in the case of debenture holders of a series who are entitled to the charge *pari passu*.

*Consequences of non-registration* :—Sec. 109 provides that if a mortgage or charge, which is required to be registered, is not registered it shall be void so far as any security on the company's property or undertaking is thereby conferred, as against the liquidator, and any creditor of the company. It may be noted that the company's obligation to repay the money borrowed under the said mortgage or charge is not affected, but on the other hand if the mortgage or charge has not been registered within 21 days, the money secured thereby shall become immediately payable. Secs. 111 to 125 deal with the register of mortgages and charges, the issue of certificate of registration, rectification of register of mortgages, the registration of satisfaction of mortgages, registration of appointment of receiver etc.

## DIRECTORS

As a company consists of a large fluctuating body of members, the management of its affairs is vested in a select body of members called the directors. A director has been defined by Sec. 2 (5) as including any person occupying the position of a director, by whatever name called. The first directors are usually named in the articles, and in default the subscribers of the memorandum are deemed to be the directors. According to Sec. 83-A every company other than a private company must have at least 3 directors. The amendment Act of 1936 has incorporated a number of sections dealing with directors and their rights and obligations.

*Appointment of Directors* :—Sec. 83-B lays down that in the absence of articles to the contrary, in the case of every company other than a private company : (i) the subscribers of the memorandum shall be deemed to be the directors of the company until first directors are appointed, and (ii) the directors of the company shall be appointed by the members in general meeting, and (iii) a casual vacancy among the directors may be filled up by the directors. It also enacts that not less than  $\frac{2}{3}$  of the whole number of directors shall be persons whose period of office shall

be liable to determine at any time by retirement of directors in rotation, Sec. 87-1 lays down that notwithstanding anything contained in the articles, in the case of every company, other than a private company, the directors that may be appointed by the managing agents, shall not exceed  $\frac{1}{3}$  of the whole number of directors. According to Sec. 84 no person shall be appointed as a director or be named by the articles as a director in the prospectus, unless before the registration of the articles or the publication of prospectus, or statement in lieu of prospectus, as the case may be, he has : (i) signed and filed with the registrar a consent in writing to act as such director, and (ii) in the case of a company not having a share capital, signed the memorandum for a number of shares at least equal to his qualification, if any, or taken from the company and paid or agreed to pay for the qualification shares or filed with the registrar a contract in writing to take and pay for the qualification shares, or filed with the registrar an affidavit to the effect that the required number of qualification shares, are registered in his name. The person who registers the memorandum and articles shall file with the registrar, a list of persons who have consented to be the directors. This section does not apply to a private company (Sec. 84).

A director who does not hold the qualification shares at the time of appointment should obtain the qualification within two months of his appointment or earlier, if so fixed by the articles. If any director contravenes this rule, he is liable to be punished with fine.

*Disqualification of Directors, and vacation of office:—*

A director must: (1) hold the qualification shares as required by Sec. 85, and (2) should not be an undischarged insolvent. A director duly qualified on the date of appointment is liable to vacate office if (i) he fails to obtain the qualification as per Sec. 85, or (ii) he is of unsound mind, or (iii) he is adjudged insolvent, or (iv) he fails to pay calls made on him within 6 months thereof, or (v) he or any firm of which he is a partner, or a private company of which he is a director, accepts or holds office of profit under the company (other than that of managing director, manager or legal or technical adviser or a banker) without the sanction of the company in general meeting, or (vi) he absents



himself from 3 consecutive meetings or from all meetings of the directors for a continued period of 3 months, whichever is longer, without leave from the board of directors, or (vii) he or any firm of which he is a partner, or any private company of which he is a director, accepts a loan or guarantee from the company contrary to Sec. 86-D, or (viii) he enters into a contract for sale or purchase of goods etc., contrary to Sec. 86-F. The articles may provide additional grounds for the vacation of office of directors.

Under Sec. 86-C power is given to a company to remove by means of an *extraordinary resolution* any director, whose period of office is liable to termination at any time by retirement of directors in rotation, before the expiry of his period of office. A new director in his place may be appointed by an *ordinary resolution*. It is indeed a very wide power given to a company but it enables the removal of a director whenever he is found to be unsatisfactory.

#### *Remuneration of Directors:—*

The remuneration of directors must be stated in the prospectus and disclosed in the balance sheet. A director is not entitled to any remuneration apart from an express agreement. Generally the remuneration is fixed by the articles, and if so it cannot be altered or increased without a special resolution. The remuneration due to directors is a debt due from the company and may be paid out of capital if there are no profits.

#### *Position of Directors:—*

A director's position in the eye law cannot be defined with precision. For certain purposes directors are said to be trustees, and for some others the agents or managers of the company. But none of these words exhausts their powers or responsibilities, but they only indicate useful points of view. Jessell M. R. describes them as : "Commercial men, managing a trading concern for the benefit of themselves and all other shareholders". It is however clear that a director like a promoter, by whatever name called, is a person occupying a fiduciary position towards the company in regard to powers conferred on him by the articles, and the capital under his control. Thus the directors are trustees of the company in exercising the power of transferring, issuing and allotting shares and making calls. As they are trustees for the company, and not

for the individual shareholders, they must always act in the best interests of the company. When they make contracts for the company, they act as its agents and they are not liable personally, unless they act in their own names. Regarding the consequences of an act or contract of a director, which is *ultra vires* see *supra*.

*Powers of Directors :—*

The articles of a company confer powers on directors, and generally there will be a clause in the articles providing that the directors may exercise all the powers of the company not required either by articles or by the Act to be exercised by the company in general meeting. The powers therefore exercised by directors are bound to be large and such as to be abused by unscrupulous directors. Directors act generally as a board and the decisions of majority of directors which would take the shape of resolutions, would prevail. If the majority exercise the power *bona fide* for the benefit of the company the court would seldom interfere with it. Matters of procedure which are left to the directors by the regulations, cannot be overruled even by a resolution of the members in a general meeting. The shareholders may control the directors when they act in their selfish interests and not in the interests of the company, or when the right to control is given to them by the articles, directors being agents, should not delegate their powers except in the case of ministerial acts or where such a delegation is permitted by the articles. By reason of their office, directors do not lose their rights as shareholders and they may vote on matters in which they are interested. The articles generally provide the quorum necessary for the meetings of the board of directors, and the required number of directors qualified to act must be present at every meeting, and in default the proceedings thereof will be vitiated. The business transacted at their meeting must take the shape of resolutions and be recorded in a minutes book signed by the chairman present.

*Duties of a Director :—*They have not been defined in the Act but they can be gathered from the leading decisions *In re City Equitable Fire Insurance Coy., Ltd.*, (1925) Ch. 407 and others. The powers of a director depend upon the nature of the company's

*Liability of Directors :—*

In the case of a company with limited liability a director is liable, like a shareholder, for payment of the debts of the company only to the limited extent of the unpaid capital on his shares and no more. But a company with limited liability, as already noticed, may appoint directors with unlimited liability, if authorised to do so by the memorandum. The member or director who proposes such a director for election or appointment, shall add to that proposal a statement that the liability of the person holding that office shall be unlimited, and a notice of that fact should also be given to the director concerned before he accepts the office or acts therein (Sec. 70). A limited company, if so authorised by its articles, may by a special resolution alter its memorandum so as to render unlimited the liability of any of its directors. On the passing of such special resolution the provisions shall be as valid as if they had been originally contained in the memorandum.

A director may be liable either to (i) strangers dealing with the company, or (ii) the company.

*(1) To strangers dealing with the company:*

We have already seen that directors cannot be made personally liable on contracts entered into by them as agents of the company, unless they are made in their own name, in which case either the company, or the directors, or both, may be made liable. A director can, in the case of a contract which is *ultra vires*, be made liable to pay damages for breach of an implied warranty of authority. Where the contract is only *ultra vires* the directors, on account of some flaw in internal management, it binds the company on the strength of the rule in *Royal British Bank v. Turquand*. (Supra). The liability of the directors in respect of mis-statements in prospectus has already been noticed.

*(2) To the company :—*

(i) A director is liable to the company for any loss caused to it on account of a contract which is *ultra vires*, though no fraud has been practised by him.

(ii) According to Sec. 86-C a director cannot escape liability to a company for negligence, default, breach of duty, or breach

of trust, by entering into a contract, exonerating himself from such liability, or even by having articles to that effect. Negligence means failure to use the care of an ordinary person in his own affairs. Therefore if a director acts within his powers, *bona fide* he cannot be made liable for mere error of judgment, or if he can show, in cases where the act is not negligent, that he acted without the knowledge of the facts which made the act complained of illegal.

(iii) A director can also be made liable for *misfeasance* i.e., where the breach of duty also constitutes breach of trust and results in loss to the company. In this case the liability is enforced by what is known as *misfeasance summons* taken out within 3 years from the date of the appointment of the liquidator, in the case of a company which is being wound up (Sec. 235). If however a company is a going concern, the director can be made liable for misfeasance in an action for damages. In the recent case of *Regal (Hastings) Ltd. v. Gulliver and others* (1942) 1 A. E. R. 378 (H. L.) it was held by the House of Lords that even if the directors made a profit on account of a purchase of the shares of the company made by them *bona fide*, or without fraud, or even for the benefit of the company, still they were liable to repay the profits, as they stand in a fiduciary relationship to the company. Also *Parker v. McKenna* (1874) 10 Ch. App. 96.

*Power of Court to exonerate Directors from liability :—*

The court is given wide powers under Sec. 281 to grant relief to directors in certain cases. It says that in any proceedings for negligence, default, breach of duty or breach of trust, against the directors of a company (and also managers, managing agents and officers of the company) if it appears to the court that (i) that they had acted honestly and reasonably, and (ii) that having regard to all the circumstances of the case including those connected with their appointment, that they ought to be excused for such negligence, breach of duty or breach of trust, the court may accordingly relieve them wholly or partly from such liability on such terms as it thinks fit. The relief under this section can be granted even on an application by the directors who apprehend that any claim will or might be made against them in respect of any negligence, default, breach of duty or breach of trust.

*Criminal liability of Directors :—*

In addition to being made liable in a civil court, a director may be punished in a criminal court for certain acts or omissions, e.g., failure to keep the register of members, failure to prepare and submit the annual list and summary, failure to send a proper report before the statutory meeting, or copies of special and extraordinary resolutions, an omission to call a general meeting within time, or allotting shares without the minimum subscription being subscribed, a failure to send a proper return of allotments, a failure to submit the balance sheet, and profit and loss account, etc., when the company is a going concern, and when the company is being wound up, a failure to submit a statement of affairs.

**Managing Agents**

*Definition :—*Sec. 2 (9-A) defines the expression “*Managing Agent*” as “a person, firm or company entitled to the management of the whole affairs of a company by virtue of an agreement with the company, and under the control and direction of the directors except to the extent, if any, otherwise provided for in the agreement and includes any person, firm or company occupying such position by whatever name called.” A person even if he is called a manager shall be deemed to be a managing agent if he really occupies that position.

The word *manager* is defined in Sec. 2 (9) as “a person who subject to control and direction has the management of the whole affairs of a company, and includes a director or any other person occupying the position of a manager by whatever name called and whether under a contract of service or not.” The distinction therefore between a manager and a managing agent is as follows :—

(1) the manager must be a person, while the managing agent may be either a person or a firm or a company;

(2) the managing agent is entitled as of right to the management of the company by virtue of an agreement with it, while the manager has actually the management of the company, whether under an agreement or not.

The system of appointing managing agents is peculiar to our country. During the last century when it was difficult for Indians to start new industries on account of the absence of technical knowledge and skill and the shyness of Indian capital, the managing agency system rendered considerable service, as it induced several British industrialists to start and maintain a number of big industries in our country. Like any other system it was not without its faults, and it was abused by dishonest managing agents. In course of time some of the evils of this system became very glaring and during the debates on the amendment Act, 1936 extreme view points were presented by those for and against the system of managing agents. The amendment Act of 1936 finally incorporated Secs. 87-A to 87-I, with a view to removing the serious defects in the system.

*Evils of the Managing Agency System :—*

The following are some of the evils noticed in the working of this system :

(1) Shareholders had no voice in the appointment of managing agents as the contract appointing them very often came into being even prior to the company's incorporation.

(2) The tenure of office of the managing agents was often very long (sometimes 40 or even 50 years) and the managing agents were practically irremovable.

(3) The managing agents overloaded the board of directors, with their nominees.

(4) The managing agents used to assign their office or remuneration, and thus sacrifice the interests of the company.

(5) The remuneration of the managing agents was often very large and out of all proportion to the profits made by the company, with the result that the shareholders sometimes did not get any dividend at all.

(6) Managing agents used to sell and purchase their goods to the company under their management on terms extremely advantageous to themselves.

(7) They were contracting loans on onerous terms and misapplying the same.

(8) They were making investments of company's monies which were not profitable.

(9) Sometimes the managing agents used to act as such for more than one company, and were using the funds of one company to help another company under their control, and thus cause loss even to the prosperous companies.

(10) They used to make the company suffer the consequences of their unprofitable contracts.

*Changes introduced by the Amendment Act of 1936 :—*

They are embodied in Secs. 87-A to 87-I and are briefly as follows :

(1) The tenure of office of managing agents of a public company cannot be fixed beyond 20 years, at a time, though they may be re-appointed (Sec. 87-A).

(2) A managing agent can be removed by a resolution passed by a general meeting if convicted of an offence in relation to the affairs of the company, punishable under Indian Penal Code and which is non-bailable. He is also liable to vacate office if he is adjudged insolvent (Sec. 87-B).

(3) A transfer of office by a managing agent, or a charge or assignment of his remuneration by a managing agent shall be void [Sec. 87-B].

(4) Where a company is wound up compulsorily or voluntarily, the contract of the managing agents terminates, but they will be entitled to recover moneys due from the company. Where the winding up is as a result of negligence or default of the managing agents they shall not be entitled to receive any compensation for the premature termination of the contract of management (Sec. 87 B).

(5) The appointment of a managing agent, variation of his contract of management, and his removal shall not be valid unless approved by a resolution of the company in general meeting [Sec. 87-B].

(6) The remuneration of a managing agent shall be a fixed sum based on the net annual profit of the company, with a provision for minimum payment in the event of its profits being inadequate, together with an office allowance to be specified in the agreement of management.

(7) An agreement to pay an additional amount in any form, whatever shall not be binding on the company unless sanctioned by a special resolution. This provision does not apply to a private company [Sec. 87-C].

(8) No company other than a private company shall lend money to its managing agent or guarantee any of his loans [Sec. 87-D].

(9) No company shall make any loan to, or guarantee any loan made to any company under the management of the same managing agents (Sec. 87-E).

(10) No company other than an investment company shall purchase shares or debentures of any company under the management of the same managing agents, unless previously approved by the unanimous decision of the board of directors of the purchasing company. (87-F).

(11) A managing agent shall not issue debentures of a company under his control except with the authority of the directors of that company (Sec. 87-G).

(12) A managing agent shall not of his own account engage in any business which is of the same nature and directly competes with the business carried on by a company under his management (87-H).

(13) The managing agents shall not appoint, directors exceeding  $\frac{1}{3}$  of the total number of directors of a company other than a private company.

## Meetings and Resolutions

The ordinary business of a company is carried on by the officers and employees of the company, under the instructions of its directors. But the ultimate control of affairs is really reserved to the company in general meeting. Meetings of the company are summoned by the directors who must give the notice required by the articles. An agenda is generally sent with the notice convening the meeting. A meeting of a company may be of the following kinds: (i) Statutory, (ii) Ordinary or Annual, and (iii) Extraordinary.

### 1. Statutory meeting.

Every company limited by shares, or limited by guarantee and having a share capital, shall within a period of not less than one month, nor more than 6 months from the date on which the company is entitled to commence business, hold a general meeting of the company's members, which shall be called the *statutory meeting*. A report called *statutory report* must be sent by the directors at least 21 days before the meeting to every member of the company. The statutory report enables all its members to have a chance of ascertaining the exact position of the company. It is necessary that the notice convening the statutory meeting, should state that it is intended to be the statutory meeting. The statutory report shall be certified by not less than two directors or by the chairman of the board of directors if so authorised, and shall contain the following particulars:

(1) the total number of shares allotted, how much has been paid up, and the consideration for the allotment;

(2) the total amount of cash received for those shares;

(3) an abstract of the receipts of the company under distinctive headings *viz.*, shares, debentures and other sources, the payments made there out and the particulars concerning the balance on hand, and on account of the estimate of the preliminary expenses of the company showing separately any commission or discount paid on the issue or sale of shares;

(4) names, addresses *etc.*, of the directors, auditors, managing agents, manager and secretary of the company;

(5) if any contract must be submitted to the meeting for approval, the particulars of the contract and the proposed modification;

(6) the extent to which under writing contracts have been carried out;



(7) the arrears of calls due from directors, managers and managing agents;

(8) the particulars of any commission or brokerage paid to any director, managing agent or manager.

The statutory report shall, so far as it relates to the shares allotted and the cash received thereon and to the receipts and payments, be certified as correct by the company's auditor. A copy of the statutory report should also be delivered to the registrar for registration. The directors shall cause a list of members to be produced at the meeting. The members of the company may discuss at the statutory meeting any matter relating to the formation of the company or arising out of the statutory report. A default in filing the statutory report, or holding the statutory meeting, renders the company liable to be wound up, but the court may condone the delay or default, and extend the time for filing the statutory report or holding the statutory meeting, as the case may be. Failure to comply with these provisions makes a director liable to fine. The provisions relating to statutory meeting and statutory report do not apply to a private company (Sec. 77).

## 2. Ordinary or Annual general meeting.

The articles of every company generally provide that there shall be an annual general meeting of its members on a particular date. Sec. 76 of the Act now makes it obligatory on every company to hold it within 18 months from the date of its incorporation, and thereafter once at least in every calendar year, and not more than 15 months after the holding of the last preceding general meeting. A default in holding this meeting renders every director or manager of the company, who is knowingly and wilfully a party to it, liable to fine. The Court has power on the application of any member, to call or direct the calling of a general meeting of the company (Sec. 76).

## 3. Extraordinary meeting.

All the general meetings of a company, other than the statutory meeting and annual meeting, are extraordinary meetings. As the name itself indicates such a meeting will be called only when there is some extraordinary business i.e., some business which must be transacted before the next ordinary meeting. According

to Sec. 78 the directors of a company shall on the requisition of the holders of not less than  $\frac{1}{10}$  of the issued share capital of the company, on which the calls or other sums then due have been paid, forthwith proceed to call an extraordinary general meeting of the company. The requisition must state the objects of the meeting and must be signed by the requisitionists and should be deposited at the company's registered office. If the directors commit default in calling the meeting within 21 days from the date of the deposit of the requisition, the requisitionists or majority of them in value may themselves call the meeting within 3 months from the date of deposit of the requisition. The manner of calling such a meeting by the requisitionists shall be the same as any meeting to be called by the directors. Any expenses incurred by the requisitionists shall be repaid to them by the company, which can recover the same from out of the fee and remuneration due to the defaulting directors.

Sec. 79 (3) lays down that if for any reason it is impracticable to call or conduct a meeting of a company in accordance with the articles, the court may of its motion, or on the application of any director, or any member of the company who would be entitled to vote at the meeting, order a meeting to be called, held and conducted in such manner as the court thinks fit, and it may also give such ancillary or consequential directions in respect of the same, and such a meeting shall be deemed to be a meeting of the company for all purposes.

*Provisions as to meetings and votes :—*

The Amendment Act of 1936 has incorporated Sec. 79 dealing with the various matters relating to a company's meetings. These provisions are binding on every company, other than a private company, and cannot be avoided even by having articles to the contrary.

*Notice :—*A meeting of a company, other than a meeting for the passing of a special resolution, can only be called by a notice in writing giving not less than 14 days notice. But with the consent of all the members, entitled to receive notice of any particular meeting, it may be convened by such sort of notice and in such manner as the members may think fit. If the articles do not provide to the contrary two or more members, holding not less than  $\frac{1}{10}$ th of the share capital which is

paid up, or if the company has not got a share capital, not less than 5% in number of members of the company, may call a meeting. Notice of every meeting of the company with a statement of the business to be transacted at the meeting, shall be served on every member of the company in the manner required by table A. But any accidental omission to give notice to, or the receipt of notice by, any member shall not invalidate the proceedings. The notices are not construed very strictly but they must be sufficient to show to the members substantially what is proposed to be done (Sec. 79).

*Mode of service of notice: —*

Regulations 112 to 116 of table A deal with how a notice may be served by a company on its members, and Sec. 79 (b) lays down that the notice of a meeting of every company shall be served in accordance with those regulations which may be stated as follows :—

(i) A notice may be given by the company by sending it by post to the registered address of the member, and it shall be deemed to be effected by properly addressing, prepaying and posting the letter containing the notice. (ii) If a member has no registered address in British India or has not supplied the same to the company, notice shall be deemed to be duly given by an advertisement in a news paper. (iii) Where there are two joint holders of a share a notice to the joint holder named first in the register is enough. (iv) In the case of death or insolvency of a member, notice may be given by sending it through post in a pre-paid letter addressed to him by name, or by the title of representatives of the deceased, or assignee of the insolvent, at the address in British India, or by giving notice in any manner in which the same might have been given if death or insolvency had not occurred. (iv) Notice of every general meeting shall be given as aforesaid to (a) every member of the company (including bearers of share warrants) and (b) every person entitled to a share in consequence of the death or insolvency of a member, who but for his death or insolvency would be entitled to receive notice of the meeting. (Articles 112 to 116 of table A).

*Voting by proxy :—*Sec. 79 (2) of the Act recognises the power of a shareholder to appoint another shareholder as a proxy to vote for him at a certain meeting or meetings of the company.

The articles generally provide for the deposit of proxy papers etc. Regulation 67 of table A gives the form of a proxy and Sec. 79 (1) (d) lays down that an instrument of proxy if it is in the form set out in Regulation 67 shall be valid notwithstanding that it is not in accordance with the articles of that company. The instrument appointing a proxy, unless the articles otherwise provide, shall be in writing under the hand of the appointer or his power of attorney, and the person who acts as a proxy must be a member of the company (Secs. 79 (1) (d) and 79 (2) (f) and (g).

*Quorum* :—The number of members who must be present at a meeting before it can lawfully commence its business is called the quorum for that meeting. The quorum for a company's meeting is generally fixed by the articles but where the articles do not so provide Sec. 79 (2) lays down that the quorum shall be two in the case of a private company, and five in the case of other companies, who shall be personally present.

*Chairman of meetings* :—Sec. 79 (2) (c) lays down that where the articles do not provide, any member can be elected by the members present at the meeting to act as its chairman. The duty of a chairman is to conduct the meeting and transact the business in the order of the agenda. He has to preserve order and secure the observance of the rules of debate. He has a discretion to put an end to the discussion of any subject with the consent of the majority present at the meeting, after it has been reasonably debated. He has to put resolutions to vote and his declaration that a resolution is carried is conclusive. When a resolution is moved, an amendment may be proposed, provided it does not go beyond the scope of the resolution. If an amendment offends this rule, the chairman can disallow it. Whenever anything is done or proposed to be done at a meeting contrary to general procedure for conducting meetings, any member can rise to a *point of order* and state the particulars of his objection. It is up to the chairman to allow a point of order.

### Votes and poll.

Sec. 79 (2) (d) provides that in the absence of articles to the contrary, in the case of a company having a share capital, every member shall have one vote in respect of each share, or each Rs. 100 of stock held by him, and in any other case every member shall have one vote. A show of hands is the common law

mode of taking votes, and in the first instance every matter must be decided by a show of hands. If the votes are equally divided the chairman has no casting vote unless the articles so provide. When the voting is by show of hands a person who is present can have only one vote, whatever might be the number of votes to which he is entitled, and he cannot exercise the right to vote as a proxy for the absentee members.

The right to demand a *poll* is a common law right and that is now made applicable to all companies by Sec. 79 (1) (c). It enacts that : (i) 5 members present in person or by proxy, or (ii) the chairman of the meeting, or (iii) any member or members holding not less than 1/10th of the issued capital which carries voting right, shall be entitled to demand a poll. In the case of a private company, if not more than 7 members are personally present, one member, and if more than 7 members are personally present, two members can demand a poll. Sec. 81 (3) lays down that any meeting at which an extraordinary or a special resolution is submitted to be passed, a declaration of the chairman on a show of hands that the resolution is carried shall, unless a poll is demanded, be conclusive evidence of that fact, without proof of the number or proportion of the votes recorded in favour of or against the resolution. It is therefore clear that a poll has to be demanded before the chairman declares the result of voting by show of hands. If a poll is demanded, the chairman may direct it to be taken in accordance with the articles either at the same meeting at which it is demanded, or at an adjourned meeting. When a poll is demanded in accordance with Sec. 81, in computing a majority reference shall be had to the number of votes which each member is entitled by the articles of the company or under the Act. (Sec. 81 Cls. 3 to 6). The important point of difference therefore between a voting by a show of hands and a poll is that in the former hands alone can be counted and not the proxies, while in the latter the number of votes which each voter is entitled by the articles is to be taken into account, and the votes by proxy will also be counted.

A company which is a member of another company may by resolution of its directors authorise its officials or any other person to act as its representative at any meeting of that other company, and such a person shall be entitled to exercise all the powers on behalf of the company which he represents, as

if he were an individual shareholder of that company (Sec. 80). Even if there be any irregularities in the matter of calling or conducting a meeting, the resolutions passed thereat would be valid if all the members were present and voted for the resolution, because the unanimous consent of the members cures all irregularities and non-observance of formalities. Even when a resolution is not passed unanimously, but only by vote of the majority, the members in the minority cannot attack the validity of the resolution, or anything done thereunder except when : (i) the act complained of is *ultra vires* the company, or (ii) it is a fraud on the minority, or (iii) it is absolutely necessary to waive the rule of supremacy of majority of shareholders, in order that there may not be a denial of justice.

*Minutes of proceedings :—*

Sec. 83 lays down that every company shall cause minutes of all its general meetings and meeting of its directors to be entered in books kept for that purpose called *minutes books*. Such minutes shall be signed by the chairman of the meeting at which the proceedings were held or by the chairman of the next succeeding meeting. Such a minute shall be evidence of the proceedings. The meetings in respect of which such minutes are made shall be deemed to have been duly called and held, and all proceedings had thereat to have been duly held and all appointments of directors or liquidator shall be deemed to be valid. The company is also required to permit a reasonable inspection of the minutes book and also furnish copies of the minutes to the members (Sec. 93).

### Resolutions

We have already seen that the business transacted at company's meetings shall be in the form of resolutions. They may be: (i) ordinary or (ii) extraordinary or (iii) special. To them may be added, resolutions requiring under the company's articles a specified majority of votes.

(1) *An ordinary resolution* is one passed by a simple numerical majority of such members, as being entitled so to do, vote in person at a meeting. Members who do not vote are not counted. Generally, the business at a meeting is only by ordinary resolution unless the Act, memorandum or articles otherwise provide.

(2) *An extraordinary resolution* is one which has been passed by a majority of not less than *three-fourths* of such members

entitled to vote as are present in person or proxy (where proxies are allowed) at a general meeting, of which notice specifying the intention to propose the resolution as an extraordinary resolution has been duly given [Sec. 81 (1)]. At least *14 days notice* of the meeting at which an extraordinary resolution is intended to be passed should be given to members [Sec. 79 (1) (a)]. At such a meeting, poll can be demanded, (*supra*) and therefore proxies will be counted for the purpose of determining the majority. An extraordinary resolution is required to be passed by the Act in the following cases:—(i) when a company is sought to be wound up voluntarily on the ground that its business cannot be continued owing to its liabilities [Sec. 203 (3)], (ii) to remove a director [Sec. 86 (3),]; (iii) to sanction an arrangement between company and creditors (Sec. 215), (iv) to sanction certain acts of the liquidator in voluntary winding up (Sec. 212).

A declaration of the chairman on a show of hands that an extraordinary resolution is passed shall, unless poll is demanded, be conclusive evidence of that fact (Sec. 81 (3)). A copy of every extraordinary resolution shall be filed with the registrar within 15 days of its passing (Sec. 82 (1)).

(3) A *special resolution* is one which has been passed by *three fourths majority* at a general meeting of which not less than *21 days notice* specifying the intention to propose a resolution as a special resolution has been duly given. All the members entitled to attend and vote at any such meeting may pass a special resolution even if 21 days notice has not been given [Sec. 81 (2)]. It need be hardly added that, in the case of a special resolution, proxies will be counted if poll is demanded. A copy of every special resolution must also be filed with the registrar within 15 days from its passing. Where articles have been registered, a copy of every special resolution for the time being in force shall be embodied in every copy of the articles, issued after the date of the resolution. If the articles are not registered, a copy of special resolution shall be supplied to every member at his request on payment of a fee. A default in complying with the provisions of this section is made punishable (Sec. 82). According to the provisions of the Act, the following matters require the sanction of a special resolution : (i) alteration of articles (Sec. 12); (ii) reduction of capital (Sec. 55); (iii) change in the name of the company (Sec. 11); (iv) alteration of the object clause of the

memorandum (Sec. 12); (v) to wind up a company voluntarily. Sec. 203 (2).

### Statement, Books, and Accounts.

Sec. 130 of the Act requires every company to keep proper books of account with respect to: (i) all receipts and expenses in the matters to which they relate; (ii) all sales and purchases of goods by the company; and (iii) assets and liabilities. They should be kept at the registered office or such other place as directors think fit and shall be open to inspection by the directors. Where the company has a branch office, it will be a sufficient compliance with the rule if proper books of accounts relating to transactions at that branch office are kept at that office and proper summarised returns made up to date at intervals of not more than 2 months are sent by it to the registered office or other place where they are to be kept. Non-compliance with these provisions is made punishable. (Sec. 130).

### Balance sheet.

A balance sheet has not been defined in the Act but may be described as "a pictorial representation of the trading position of the company, easily appreciated not by ignorant people but by persons who are reasonably able to understand commercial expressions and conditions." Sec. 131 enacts that the directors of every company shall at some date not later than 18 months after the incorporation of the company, and subsequently once at least in every year lay before the general meeting *a balance sheet and profit and loss account*, or in the case of a company not trading for profit an *income and expenditure account* for the period. The period in respect of which they should be prepared is, in case of the first account from the date of incorporation, and in other cases since the preceding account up to a date not earlier than the date of the meeting by more than 9 months, or if the company carries on business outside British India by more than 12 months. The registrar is empowered to extend the period by a period not exceeding 3 months. The balance sheet and the profit and loss account or income and expenditure account, shall be audited by the company's auditor and his report shall be attached thereto or it shall be referred to in the aforesaid documents, and they shall be read before the company in general meeting, and should be



made available for inspection by any member of the company. Every company other than a private company shall send a copy of the balance sheet and profit and loss account or income and expenditure account, which have been audited, along with the auditor's report to every member of the company at least 14 days before the meeting at which it is to be laid. A similar right of inspection and receiving copies of the above named documents is given to holders of preference shares and debentures of a company (Sec. 146). The company should deposit copies of those documents at the company's registered office within like period.

#### Contents of Balance sheet.

The balance sheet of a company shall contain a summary of: (i) the property of the company and assets and (ii) of the capital and liabilities of the company, giving such particulars as will disclose the general nature of those liabilities and assets, and how the value of the fixed assets has been arrived at. It is required to be in form F in the II schedule (Sec. 132). It may be noted that according to that form the balance sheet should show separately (i) the preliminary expenses, (ii) the expenses of any issue of shares or debentures, (iii) the amount of goodwill, (iv) all debts of company which are secured on any of its assets as well as those unsecured, (v) commissions and discounts on shares and debentures, (vi) particulars as to debentures which have been redeemed, (vii) shares in and loans to subsidiary companies, (viii) loans by subsidiary companies, (ix) particulars as to profits and losses of subsidiary companies (x) amounts of loans to managing agents, directors or officers, (xi) total amount paid to managing agents, directors and officers towards their remuneration etc.

**Profit and loss account:** It should include the following particulars: (i) the total of the amount paid as fees or percentages etc., to managing agents and directors as remuneration, and (ii) the total of the amount written off for depreciation. The remuneration received by the directors on account of being directors of some other companies should be shown at the foot of that account (Sec. 132).

In the case of a company which holds shares in subsidiary companies the balance sheet of the holding company shall be accompanied by: (1) the last audited balance sheet, profit

and loss account, and auditor's report of the subsidiary company, which are duly authenticated, and (2) a statement showing how the profits and losses of subsidiary companies have been dealt with.

The balance sheet shall also show in particular how and to what extent (a) provision has been made for the losses of the subsidiary company either in the accounts of that company, or the holding company or of both, and (b) losses of the subsidiary company have been taken into account in arriving at the profits and losses of the subsidiary company as disclosed in its accounts. Where the auditor's report on the balance sheet of the subsidiary company does not state without qualification that the auditors have obtained all the information and explanations they have required, the balance sheet of the holding company shall contain particulars of the manner in which the report is qualified. (Sec. 132-A).

The balance sheet and profit and loss account must, in the case of a banking company, be signed by the manager and all the directors where there are only three, and by at least three when there are more than three. In the case of any other company it must be signed by at least two directors, and in the case of a private company by the sole director and by the manager or managing agent, if any, of the company. An exception is made where some of the directors are outside British India. In such a case the balance sheet and profit and loss account shall be signed by all the directors for the time being in British India. But if there is only one director in British India it shall be signed by him, and in such a case there shall be subjoined to the balance sheet and profit and loss account a statement signed by the director explaining the reason for non-compliance with the said provision. Default in compliance with the provisions of Sections 131, 132 or 132-A is punishable with fine, which may extend to Rs. 500 (Sec. 133).

#### Director's Report

The directors shall prepare and attach to every balance sheet a report with respect to:

- (i) the state of company's affairs ;
- (ii) the amount if any which they recommend should be paid as dividend ; and

- (iii) the amount, if any, which they propose to carry to the reserve fund, general reserve, or reserve account, shown specifically in the balance sheet, or intended to be shown specifically in a subsequent balance sheet.

Such a report may be signed by the chairman of the directors if so authorised by its articles (Sec. 131-A).

*Note:*—Sec. 134 requires that after the balance sheet, and profit and loss account or income and expenditure account, have been laid before the company at the general meeting three copies thereof signed by the manager or secretary of the company, shall be filed with the registrar at the same time as the copy of the annual list and summary prepared in accordance with Sec. 32. If the balance sheet has not been adopted, a statement of that fact with the reasons therefor should be annexed to the balance sheet, and copies thereof should be filed with the registrar. This section does not apply to a private company. A default in compliance with these provisions is made punishable (Sec. 134). Every member of a company is entitled to be furnished with copies of the balance sheet, profit and loss account or income and expenditure account, as the case may be, on payment of a fee.

#### Statement to be published by banking and other companies

Every banking company, insurance company, or a deposit, provident or a benefit society, is required in addition to complying with Secs. 130 to 134, to make a statement in the form marked G in the III schedule, before it commences business and also on the first Monday in February, and first Monday in August every year during which it carries on business. A copy of that statement together with a copy of the last audited balance sheet shall be displayed at the registered office and every branch office till the display of the next following statement. Every member and creditor of the company is entitled to a copy of the same on payment of a fee. This section is not made applicable to a life assurance company or a provident insurance society which has to file a balance sheet in the prescribed form with special certificates as prescribed by the Insurance Act of 1938 (Sec. 136).

#### Investigation by the Registrar

After a perusal of any document required to be submitted to him the registrar may call on any company to furnish within a time fixed any information or explanation which he may think

necessary in order that the document submitted to him may afford full particulars. Thereupon the officers of the company are bound to furnish such information, and if any default is committed, the persons liable to furnish such information or explanation shall be liable to fine, and may also be required by the Court to produce such documents as in its opinion may reasonably be required by the registrar for his investigation, and he will be allowed to inspect the same. The registrar after receiving such information and explanation, may annex the same to the original document to which it relates. If no such information or explanation is furnished within the specified time, or after perusal of the same the registrar is of opinion that it discloses an unsatisfactory state of the company's affairs, or does not disclose a full and fair statement of the company's matters, to which they relate, he shall report in writing the circumstances of the case to the Local Government. The registrar is given the power to investigate as stated above, even on the representations and materials placed by a contributory or a creditor to the effect that the business of the company is: (i) carried on in fraud of creditors, or (ii) in fraud of persons dealing with company, or (iii) for a fraudulent purpose. The identity of the creditor or contributory who furnishes that information shall not be disclosed except where the registrar is satisfied that the representation on which the registrar has taken action is frivolous or vexatious. The aforesaid powers can also be exercised by the registrar in respect of documents which the liquidator is required to file under the Act (Sec. 137).

After receipt of the report by the registrar the Local Government may take action by appointing one or more competent inspectors to investigate into the affairs of the company and report thereon. The Local Government may appoint inspectors to investigate into and report on the affairs of (1) a banking company having a share capital, on the application of members who hold not less than  $\frac{1}{5}$ th of the shares issued, (2) any other company having share capital, on the application of members holding not less than  $\frac{1}{10}$ th of the shares issued, (3) a company not having a share capital, on the application of not less than  $\frac{1}{5}$ th in number of the persons on the company's register of members, (4) any company on a report by the registrar under Sec. 137 (5). The Government shall, in

the case of an application by members, require evidence showing that the applicants have good reasons, and are not actuated by malicious motives, and may also require the applicants to furnish security for payment of costs of the enquiry. The officers of the company shall be bound to produce before the inspector all books and documents of the company, and the inspector may examine on oath any officer of the company in relation to its business.

After completing the investigation the inspectors shall report their opinion to the Local Government, and copies of the same shall be forwarded by the Government to the registrar, to the company, and to the applicants at their request. The expenses of the investigation shall have to be borne by the applicants unless the Government directs otherwise. Where the investigation is held on the report of the registrar, the expenses shall be paid out of the assets of the company. The registrar is bound to keep a copy of the inspector's report sent to him with the other records of the company. If the Government is of opinion that any person has been guilty of any offence in relation to the company, for which he is criminally liable, it may refer the matter to the Advocate-General or the Public Prosecutor who, if he is of opinion that the case is one in which prosecution ought to be instituted, shall cause the proceeding to be instituted. Thereupon it shall be the duty of all officers and agents of the company to render all possible assistance in connection with the prosecution. If the proceedings result in a conviction of the director, manager or other officer of the company, he shall not, without leave of the court, be a director, or in any way directly or indirectly be concerned in, or take part in the management of a company for a period of 5 years thereafter. A copy of the inspector's report shall be admissible in any legal proceeding as evidence of his opinion on matters contained in the report (Secs. 138 to 141-A and Sec. 143).

*Note:—*A company may by special resolution appoint inspectors to investigate its affairs and they shall have the same powers and duties as inspectors appointed by the Local Government, except that instead of reporting to the Local Government they shall report to such persons as the company in general meeting may direct (Sec. 142).

### Inspection and Audit

**Auditors:**—Secs. 144 and 145 deal with the auditors of companies. Though the articles usually provide for the appointment of auditors and the auditing of company's accounts, the Legislature enacted certain provisions which are obligatory on all companies.

*Qualifications and appointment :—*

No person can be appointed as an auditor of a company other than a private company, not being the subsidiary company of a public company, unless he holds a certificate from the Central Government entitling him to act as an auditor of a company. A firm of auditors holding such certificates may be appointed by their firm name. The Central Government is empowered to frame rules, providing for the grant, renewal, or cancellation of such certificate and prescribing the conditions and restrictions for such grant, renewal or cancellation.

An auditor should be appointed by every company at each annual general meeting and he shall hold office till the next annual general meeting. In default of such appointment the Local Government, on the application of any member of the company, may appoint an auditor of the company for the current year and fix his remuneration to be paid by the company. The following persons shall not be appointed as auditors of a company: (i) a director or officer of the company; (ii) a partner of such director or officer; (iii) in the case of a company other than a private company, not being the subsidiary company of a public company, any person in the employment of such director or officer; (iv) any person indebted to the company. If after appointment the auditor becomes indebted to the company his appointment terminates.

Except in the case of a retiring auditor the notice of a member's intention to nominate a person to the office of an auditor at the annual general meeting shall be given by the member to the company *fourteen days* before such meeting. The company shall send a copy of such notice to the retiring auditor, and shall give notice thereof to its members, either by advertisement or in some other mode authorised by articles, not less than 7 days before that meeting. The first auditors of a company may be appointed by the directors before the statutory meeting, and if so appointed

shall hold office until the first annual general meeting, unless previously removed by a *resolution of the company in general meeting*, in which case such members at that meeting may appoint auditors. The directors may fill any casual vacancy in the office of an auditor, but while any such vacancy continues, the surviving or continuing auditor or auditors may act. The remuneration of auditors shall be fixed by the *company in general meeting*, but the remuneration of auditors appointed before the statutory meeting, or to fill any casual vacancy may be fixed by the directors (Sec. 144).

### Powers and Duties of Auditors

Every auditor of a company shall have right of access to all books and accounts and vouchers of the company. He shall be entitled to require from the directors and officers of the company such information and explanation as may be necessary for the performance of his duties. The auditors shall make a report to the *members of a company*, on the accounts examined by them, and on every balance sheet and profit and loss account laid before the company in general meeting during their tenure of office. Their report shall state the following: (i) whether or not they have obtained all the information and explanations they required; (ii) whether or not in their opinion the balance sheet and the profit and loss account referred to in their report are drawn up in conformity with the law; (iii) whether or not such balance sheet exhibits a true and correct view of the state of the company's affairs according to the best of their information and the explanations given to them and as shown by the books of the company; and (iv) whether in their opinion the books of account have been kept by the company as required by Sec. 130. If any of the matters referred to above is answered in the negative or with a qualification, the report shall state the reasons for such answer. In the case of a banking company it is sufficient if the copies of extracts from the books and accounts of the branch transmitted to the head office have been made available by it to the auditor. The auditors shall be entitled to receive notice of and to attend any general meeting of the company at which any accounts which have been examined or reported on by them are to be laid before the company, and may make any statement or explanation they desire with respect to the accounts. An auditor

making a report which does not comply with the requirements stated above, and every auditor who is knowingly and wilfully a party to the default shall be punishable with fine which may extend to Rs. 100 (Sec. 145).

It may be noted that the section only specifies the contents of an auditor's report, but does not say anything about the care that should be exercised by an auditor in the discharge of his duties. The diligence to be exercised by and the duties of an auditor have been laid down in two leading decisions, viz., *Kingston Cotton Mills Coy., Ltd., In re.* (1896) 2 Ch. 279, and *City Equitable Fire Insurance Company, In re.* (1925) Ch. 407, as follows : an auditor is bound to make all reasonable and proper investigations of the accounts and stocks, and if as a reasonable and prudent man he is of opinion that something is wrong it is his duty to invite the attention of the members to it. He is entitled to rely on documents produced by the company's officers unless he has reason to believe that they are dishonest.

His duties may be summarised as follows :

(1) An auditor's responsibility depends upon the terms of his engagement, either by a special contract or as contained in the articles, and he must therefore acquaint himself with his duties under the articles and under the Act.

(2) He must see that the books show the true financial position of the company. It is not for him to consider or advise whether the business of a company is prudently or imprudently carried on, but his duty is to report to the shareholders whether the balance sheet exhibits a true and correct state of the company's affairs.

(3) He must report generally on the state of accounts and on all material points, and draw the attention of the shareholders if there is anything wrong. He must be honest and exercise reasonable care. Otherwise he will be liable in damages.

(4) He must not confine himself to the task of verifying the arithmetical accuracy of the balance sheet. He must require whether it is substantially true and correct.

(5) He must see that all payments are proper, by a fair and reasonable examination of the vouchers, and if he discovers any illegal or improper payments, he must state it in his report,



(6) He must make a personal inspection of the securities and should not be content with a certificate of parties that the securities are in their custody. The auditor must also see whether the securities are in the custody of proper persons and report to the shareholders if it is otherwise.

It is therefore the duty of an auditor to exercise the skill, care and caution which a reasonably competent, careful and cautious auditor would use under the circumstances of the case. Lopes L. J. in the case of *Kingston Cotton Mills Coy., Ltd.* observed:

“An auditor is not bound to be a detective or, as was said, to approach his work with suspicion or with a foregone conclusion that there is something wrong. He is a watch dog but not a blood hound. He is justified in believing the tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely on their representations provided he takes reasonable care. If there is anything calculated to excite suspicion he is bound to probe it to the bottom but in the absence of anything of that kind he is only bound to be reasonably careful and cautious”.

Thus auditors cannot be made liable for not tracing out ingenious and carefully laid schemes of fraud when there is nothing to rouse their suspicion, and when they are perpetrated by the tried servants of a company and have not been detected by the directors for several years.

*Note:*—An auditor who commits a breach of duty can be made liable in damages and if the company is being wound up he can be made liable for misfeasance under Sec. 235.

### Contracts by companies

In order that a company may be bound by contracts made on its behalf by its officers in the course of the management of its business, certain conditions have to be satisfied. Secs. 88 to 91-D lay down the rules in this behalf. Contracts on behalf of a company may be made as in the case of an individual either : (i) by writing or (ii) by word of mouth, by any person acting under its authority express or implied, and they shall be effectual in law and binding on the company and its successors. In the case of bills of exchange, hundis, or promissory notes they should be made, drawn, accepted or endorsed in the name of, or by or on behalf of the company by any person acting under its authority express or implied. A company may by writing under its seal appoint a person as its attorney to execute

deeds on its behalf and to use his seal where sealing is required, and such execution and use of seal would be as effective as if it were executed by the company under its common seal (Secs. 88 to 90). Sec. 91 empowers a company to have an official seal which shall be a facsimile of the common seal of the company for use outside the limits of British India.

*Disclosure of interest by director, and prohibition of voting by interested directors:*

A director who is interested in any contract or arrangement entered into by or on behalf of the company should disclose the nature of his interest at the meeting of directors at which the contract or arrangement is determined. If he acquires an interest subsequently, he must disclose it at the first meeting of the directors after the acquisition of such interest. A general notice is sufficient for this purpose. A register shall be kept by the company in which particulars of all contracts or arrangements above referred to shall be entered (Sec. 91-A). No director shall vote as a director on any contract or arrangement in which he is interested, nor shall his presence count for the purpose of a quorum at the time of such vote, and if he does so vote it shall not be counted. But directors can vote on a contract of indemnity against any loss which they may suffer by reason of becoming or being sureties for the company. This prohibition does not apply to a private company.

*Disclosure in the case of contract appointing a manager:—*

Where a director is directly or indirectly interested in a contract for the appointment of a manager or a managing agent of the company, or its variation, the company shall within 21 days from the date of entering into the contract or its variation, send to every member an abstract of the terms of such contract or variation together with a memorandum clearly stating the nature of the interest of the director in the same. The contract shall be open to inspection of any member at the registered office of the company (Sec. 91-C).

*Contracts by agents of company in which company is undisclosed principal:—*

Every manager or other agent of a company, other than a private company, who enters into a contract for or on behalf of a

company, in which contract the company is an undisclosed principal shall, at the time of entering into the contract make a memorandum in writing of the terms of the contract, and specify therein the person with whom it has been made. Every such manager or agent shall forthwith deliver the said memorandum to the company and send copies to the directors and the same shall be filed in the company's office and laid before the directors at the next director's meeting. Default in compliance with the aforesaid provisions renders the contract void against the company at its option.

*Note:—*Non-compliance with the provisions of Secs. 91-A to 91-D is made punishable.

### Arbitration and compromise

Companies, like individuals, may sometimes find it necessary to enter into an agreement for compromising the disputes between them and others. Sec. 152 recognises this right and it lays down that a company may by written agreement refer to arbitration, in accordance with Indian Arbitration Act 1940, an existing or future difference between itself and any other company or person. Companies which are parties to an arbitration may delegate to the arbitrator, power to settle any terms, or to determine any matter capable of being lawfully settled by the companies themselves or by their directors. The provisions of the Indian Arbitration Act 1940 are made applicable to these references. Sec. 153 deals with the power of a company to compromise with creditors and members. It lays down that the Court may, on the application of the company, or any creditor, or member of the company, or of a liquidator, if the company is being wound up, order a meeting of the creditors or members, as the case may be, or any class of such creditors or members, to be held in every case where a compromise or arrangement is proposed between a company and its creditors, or members, or any class of them. If a majority of  $\frac{3}{4}$  in value of the creditors, or members, or any class of them, agree to any compromise or arrangement it shall be binding on the creditors or members or any class of them, and also the company, or the liquidator, or contributory, as the case may be, provided it is sanctioned by the Court. Copy of such order of the Court should be filed with the registrar and a copy of the same should be annexed to every copy

of the memorandum subsequently issued by the company. Otherwise the order would have no effect. Non-compliance with this provision makes the company and every officer knowingly and wilfully in default to a fine. After an application under this section has been made, the Court may stay the commencement or continuation of any suit or proceeding against the company. These provisions apply to a company liable to be wound up under this Act. An appeal lies from an order of the Court refusing or sanctioning the proposed compromise or arrangement under this section.

The section applies to compromises as well as arrangements, and an arrangement is held to have wider meaning than compromise, though it means something analogous to it, e.g., re-organisation of capital involving interference with preferential rights, a scheme between a company in liquidation and its creditors, by which debenture holders are deprived of a part of their security, sale of assets for shares in a new company have all been held to be arrangements. The court will not approve and sanction a scheme or arrangement simply because it has been sanctioned by a majority of shareholders, It would also consider whether : (i) the scheme is proper and fair; and (ii) it is made in good faith, and (iii) the majority has been acting bona fide and in the interests of the class to which it belongs, and the minority whose interests are in conflict with the majority has not been over-ridden by the majority ; and (iv) the arrangement does not prejudice creditors whose rights would have been preferential, if a petition for winding up had been allowed to be prosecuted.

Sec. 153-A deals with provisions for facilitating arrangements and compromises which have been proposed for the purpose of a scheme for the reconstruction of a company, or the amalgamation of two or more companies. Sec. 153-B gives the power to acquire shares of shareholders who dissent from the scheme or contract approved by the majority.

### Reconstruction and Amalgamation

Reconstruction occurs when a company transfers the whole of its undertaking and property to a new company under an arrangement by which the shareholders of the old company are entitled to receive some shares or other similar interest in the

new company. Amalgamation occurs when two or more companies unite their undertakings into a single undertaking. There may be an amalgamation either by the transfer of two or more undertakings to a new company or by the transfer of one or more undertakings to an existing company. Sec. 153-A lays down that where an application is made to the Court under Sec. 153 for sanctioning a compromise or arrangement, and it is shown that the said compromise or arrangement had been proposed for the purpose of reconstruction of any company or companies, or the amalgamation of any two or more companies, and that under the said scheme the whole or any part of the undertaking or property of any company concerned in the scheme (called the *transferor company*), is to be transferred to another company (called the *transferee company*), the court may by the order sanctioning the compromise or arrangement, or by subsequent order make provision for all or any of the following matters :

- (1) the transfer of the whole or part of the undertaking, or property as well as liabilities of the transferor company ;
- (2) the allotment or appropriation of any shares, debentures, policies, or other like interests among the members of the transferor company ;
- (3) the continuation of any legal proceedings by or against any transferor company ;
- (4) the dissolution without winding up of any transferor company ;
- (5) the provision to be made for any persons who within a specified time dissent from the compromise or arrangement ;
- (6) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

Where an order of the Court under this section provides for the transfer of property or liability, that property shall be transferred to, and vest in, and the liabilities shall become enforceable against, the transferee company. A copy of the order of the Court under this section should be delivered to the registrar for registration within 14 days after the completion of the order.

*Power to acquire shares of dissenting shareholders :—*

Sec. 153-B empowers the transferee company to compulsorily acquire the shares of members who dissent from the scheme or contract approved by the majority. It lays down that where a scheme or contract involving the transfer of shares or any class of shares of the transferor company to the transferee company

has been approved within 4 months after the making of the offer in that behalf by its holders of not less than  $\frac{3}{4}$  in value of the shares effected, the transferee company, may within two months after the expiration of the said 4 months, give notice to any dissenting shareholder that it is desirous to acquire his shares. Where such a notice is given, the transferee company shall, unless the court orders otherwise, be entitled and bound to acquire those shares on the same terms as those of the majority shareholders who have approved. Where such a notice has been given by the transferee company, and the Court has not ordered to the contrary, the transferee company shall, on the expiration of one month from the date on which notice has been given, transmit a copy of the notice to the transferor company and pay or transfer to the transferor company the amount or consideration representing the price payable by the transferee company for the shares which have been acquired by virtue of this section. The transferor company shall thereupon register the transferee company as the holder of those shares. Any sums thus received by the transferor company shall be paid into a separate bank account, and it shall be held by that company on trust for the several persons entitled to the shares in respect of which it was received. In this section the expression dissenting shareholder includes a shareholder who has not assented to the scheme or contract as well as any shareholder who has so assented, but has failed to transfer his shares to the transferee company in accordance with the scheme or contract.

### WINDING UP OF COMPANIES

A company may have to be wound up for a number of reasons, including bankruptcy. Winding up (also called liquidation) of a company, is a proceeding for the realisation of the assets, the payment of the creditors, and the distribution of the surplus, if any, among the shareholders, so that the company may be finally dissolved. The liquidation proceedings of a company resemble the bankruptcy or insolvency proceedings of an individual, and also the proceedings for dissolution of a firm, in some respects. There are however several points of dissimilarity between the two which are of great consequence. For example an individual can be declared an insolvent or bankrupt only when he is unable to pay his debts. A company on the other hand cannot be

declared bankrupt or insolvent even when it is unable to pay its debts, and may be wound up even when it is able to pay its debts. The principles of bankruptcy law apply to some extent to companies in liquidation, but they are entirely governed by the provisions of the Indian Companies Act, Part V.

### Modes of Winding up.

The winding up of a company may be either :

- (1) by the Court, also called *compulsory winding up*, (Secs. 156 to 202).
- (2) *voluntary* i.e. without the intervention of the Court, (Secs. 203 to 220).
- (3) *subject to supervision of the Court*, (Secs. 221 to 226).

*Voluntary winding up* may again be one of two kinds :

- (i) Member's voluntary winding up, and
- (ii) Creditor's voluntary winding up.

The provisions of this Act with regard to winding up apply to all the above modes, except where the contrary is expressed. (Sec. 155).

Companies which can be wound up under this Act, are :

- (1) those incorporated under this Act, or under the previous Acts;
- (2) unregistered companies ;
- (3) companies incorporated by Royal Charter ;
- (4) foreign and colonial companies having assets and liabilities in India;
- (5) life insurance companies;
- (6) industrial and provident societies;
- (7) defunct companies.

### Winding up by Court or compulsory winding up

This is by far the most important and usual form of winding up. According to Sec. 162 the Court may wind up a company in the following cases :

- (1) if the company has *by its special resolution* resolved that the company be wound up by the Court. An application on

this ground is unusual because the shareholders would prefer to have a voluntary winding up instead of one by the Court.

(2) if default is made in filing the statutory report (*supra*). This can be a ground for winding up only at the instance of a shareholder, and the petition for winding up should be filed only after the expiration of 14 days after the last day on which the meeting ought to have been held.

(3) if the company does not commence its business within one year from the date of its incorporation or suspends its business for a whole year. In this case the court has a discretion and if the delay complained of or the period of suspension, as the case may be, has been satisfactorily accounted for, and the majority of shareholders desire to carry on the business, the Court may refuse to pass the order for winding up.

(4) if the number of members is reduced, in the case of a private company below two, or in the case of any other company below seven. (*Supra*).

(5) if the company is unable to pay its debts. Sec. 163 enacts that a company shall be deemed to be unable to pay its debts :—(i) if a creditor to whom the company is indebted in a sum exceeding Rs. 500 has served on the company a demand requiring the company to pay the amount due, and the company has for 3 weeks neglected to pay the sum; or (ii) if execution or other process issued on a decree or order of a Court in favour of a creditor of a company, is returned unsatisfied in whole or in part; or (iii) if it is proved to the satisfaction of the Court that the company is unable to pay its debts having regard to its contingent as well as prospective liability. When the company is unable to pay its debts the court necessarily orders its winding up. If the debt is contingent or prospective, the Court has to consider whether the company is commercially solvent, and it is not necessary that the debt due to the particular creditor should be more than Rs. 500.

(6) if the court is of opinion that it is just and equitable that the company should be wound up. (Sec. 162). This is the last, but by no means the least important ground on which a company may be wound up, because it has been held that this clause includes grounds not *ejusdem generis* with the grounds mentioned above, and that under this clause the Court is given



unfettered jurisdiction to order winding up, according to its notions of justice and equity. *D. Davis and Co. Ltd v. D.V. Brunswick Ltd. and others* A.I.R. 1936 P.C. 114 (from New South Wales). Thus it was held that the Court can order winding up under this clause when : (i) there is a preponderating influence of shareholders whose conduct requires investigation, or (ii) where a company is commercially insolvent, or (iii) where it is a mushroom or bubble company ; or (iv) where there is deadlock in the management of a company; or (v) where the substratum of the company has disappeared i.e., the business of the company cannot be carried on account of physical impossibility, *Cotman v. Brougham* (1918) A.C. 514 ; or (vi) where there is no *bona fide* intention to carry on business ; or (vii) where the company's management do not command the confidence of the shareholders.

*Who can apply for compulsory winding up :—*

According to Sec. 166 an application to the Court for winding up shall be by a petition, presented either by :

(i) the company; or (ii) any creditor or creditors including contingent, or prospective creditors; or (iii) a contributory or contributories; or (iv) by all, or any of those parties together or separately; or (v) the registrar.

#### Creditor's petition.

A creditor in equity, as well as a creditor at law, and, even a contingent or prospective creditor may apply for winding up, but in the case of a contingent or prospective creditor the Court will not hear the petition unless a *prima facie* case has been made out and security for costs is given [Sec. 166 (c) ]. A secured creditor can also be a petitioning creditor though it is not free from doubt whether a debenture holder whose debenture is secured by a trust-deed can present a petition for winding up. Where the petitioner is a creditor whose debt is presently payable, and who is unable to realise it from the company, the Court has no discretion to refuse the petition, but if the majority of the creditors of the company oppose the application, the Court may refuse the same.

#### Contributory's petition.

A contributory can also apply for winding up, but he shall not be entitled to present a petition unless ;

(i) the number of members is reduced below two, in the case of a private company, or below seven, in the case of a public company; or

(ii) the shares in respect of which he is a contributory or some of them were originally allotted to him, or have been held by him and registered in his name for at least 6 months during the 18 months before the commencement of the winding up, or have devolved on him through the death of a former shareholder [Sec. 166 (a) ]. It may be mentioned that a contributory is not entitled to claim an order for winding up as of right like a creditor. The Court has always a discretion in the matter and it may refuse his application if it is opposed by a majority of the contributories unless: (i) the substratum is gone, or (ii) there are special circumstances which render it necessary for the Court to interfere e.g. the conduct of a director requiring investigation. A contributory's application for winding up cannot be maintained when there is a voluntary winding up already in progress, unless it is shown : (i) that the contributory is prejudiced by the voluntary winding up (Sec. 218); or (ii) unless the resolution was fraudulently passed. A contributory can file a petition for winding up on the ground that the statutory meeting was not held or the statutory report has not been filed.

#### Registrar's petition

By the amendment Act of 1936 the registrar is also given the power to present a petition for winding up of a company. This provision is intended to prevent the continuance of insolvent companies, but according to Sec. 166 (a) the registrar cannot present such a petition unless : (i) from the financial condition of the company, as disclosed in its balance sheet or from the report of an inspector appointed under Sec. 138, it appears that the company is unable to pay its debts, and (ii) the previous sanction of the Local Government has been obtained for the same.

#### Procedure in winding up by Court

An order for winding up shall operate in favour of all the creditors and all the contributories, as if it is made on their joint petition. Winding up of a company by the Court shall be deemed to commence at the time of the presentation of the petition for

winding up. At any time after the filing of the petition and before making an order for winding up the Court may upon the application of a company, or of any creditor, or contributory restrain by an injunction further proceedings in any suit or proceeding against the company on such terms as it thinks fit.

On hearing the petition the Court may either : (i) dismiss it with or without costs; or (ii) adjourn the hearing conditionally or unconditionally; or (iii) make any interim order; or (iv) or any order that it deems just.

The Court shall not refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets. Where the Court makes an order for the winding up of a company it shall, except where a liquidator is appointed simultaneously, forthwith cause intimation thereof to the official receiver (Sec. 170). It may be noted that a winding up order is not a judgment in *rem* and although it is binding on the company, its members and all persons claiming under it, unless it is properly made, it is not binding on outsiders.

Once a winding up order is made, or a provisional liquidator is appointed, no suit or other legal proceeding shall be proceeded with, or commenced against the company except by leave of the Court and subject to such terms as the Court may impose (Sec. 171). This provision is intended to prevent wasteful litigation and defeat of the object of compulsory winding up, viz., the realisation and protection of assets and an administration of its affairs by the Court. Leave will be granted by the Court if the question at issue in the suit or proceedings cannot conveniently be dealt with in the winding up proceedings. A secured creditor can pursue any remedy he chooses and the Court will grant him leave to sue, unless the liquidator is prepared to give him all the relief to which he will be entitled in his action. On the making of the winding up order the petitioner as well as the company must file with the registrar a copy of the order within one month of its being made. The registrar shall make a minute of the same in his books and notify it in the Local Official Gazette. An order for winding up shall be deemed to be notice of discharge to all the servants of the company, except when the business of the company is continued (Sec. 172). The Court is

given the power to stay winding up proceedings in the interests of the creditors and having regard to the trading operations of that company (Sec. 173). In all matters relating to winding up, the Court may have regard to the wishes of creditors or contributories (Sec. 174).

#### Ordinary powers of Court in winding up proceedings

After making an order for winding up, the Court has to do a number of things and for this purpose, it is given the necessary powers which are described hereunder :

1. The Court shall settle a list of contributories, and rectify the register of members, if necessary, and shall cause the assets of the company to be collected and applied in discharge of its liabilities. In settling the list of contributories, a distinction shall be made between persons who are contributories in their own right, and those who are contributories as legal representatives.

2. The Court may require any contributory and any trustee, receiver, banker, agent or officer of the company to deliver or transfer to the official liquidator within a specified time, any property, money or documents in his hands to which the company is *prima facie* entitled. This is a summary procedure for realisation of the company's property from the persons enumerated above and it will be exercised only in cases which directly come within the section. In other cases, the Court will direct the official liquidator to file suits against persons in possession of the company's property or documents.

3. The Court may make an order on any contributory to pay to the company any money due from him, or from the estate which he represents, exclusive of any money payable by virtue of any calls. In making this order, the Court may, in the case of an unlimited company allow the contributory to set off any money due to him, or to the estate which he represents, from the company on any independent dealing or contract, but a set off will not be permitted in respect of money due to him by way of any dividend or profit. In the case of a director of a limited company, whose liability is unlimited, a similar right will be permitted. In the case of a company, whether limited or unlimited, *after all the creditors are paid in full*, any money due on any account to a contributory from the company may be allowed to

him by way of a set off against any subsequent call (Sec. 186). This section again provides a summary procedure for recovery of monies *due from a contributory*, other than monies payable in respect of calls made by the liquidator. The object of this section is only to avoid proceedings in different courts but it does not deprive the liquidator of his right to recover them by a suit.

4. The Court may, after the winding up order, and either before or after it has ascertained the sufficiency of the assets of the company, make calls on, and order payment thereof by, all or any of the contributories settled on the list, for payment of any money which it considers necessary to satisfy the debts and liabilities and expenses of winding up etc. But the amount called should not exceed the extent of the liability of the contributories. The Court, while making a call, may take into account the probability that some of the contributories may be unable to pay the call (Sec. 187).

*Note :—*This section deals with the power of making calls in winding up, and realising it by a summary procedure, but it does not deprive the liquidator from filing a suit for recovery of the call amount. The liquidator can make calls only after the list of contributories is settled and after obtaining the leave of the Court, but he is not fettered by the provisions in the articles with regard to calls. If any contributory fails to pay the amount called by the liquidator within the specified date, the liquidator has to apply to the Court for an order for enforcing the calls, and that order is called '*a balance order*' and it is enforceable as a decree. It may be noted that the unpaid call money cannot be set off by a contributory against a debt due to him from the company, because once the company is ordered to be wound up, the right and liabilities of parties are not governed by the relation of a debtor and creditor to which the law of set off applies. The reason is that the amount called up from contributories is not a *debt* but a *contribution to the assets* of the company to make up any deficiency, and to allow a set off against the call would amount to pay the claim of the contributories in full out of a fund which ought to be distributed rateably, and consequently contrary to the scope of the Act. Set off against calls made in winding up is however allowed : (i) where subsequent to winding up a contributory becomes a bankrupt; or (ii) where the company becomes indebted to the contributory in the winding up proceedings.

5. The Court may order any contributory, purchaser, or other person from whom money is due to the company to pay the same into the account of the official liquidator in any scheduled bank (Sec. 188).

*Note* :—An order made by the Court on a contributory shall be conclusive evidence that the money stated therein to be due, or ordered to be paid is due from him. The other contents of the order are admissible in evidence as against all persons as being correct.

6. The Court may fix a time within which creditors should prove their debts, failing which they would be deprived of the benefit of participating in any dividend declared prior to the date when they prove their debts. They will however have the right to participate in dividends declared subsequently.

7. The Court shall adjust the rights of the contributories among themselves, and distribute any surplus among the persons entitled thereto.

8. The Court may, in the event of assets being insufficient to satisfy the liabilities, make an order as to the payment out of the assets, of costs, charges and expenses in the winding up, in such order of priority as it thinks just (Sec. 193).

#### Extraordinary powers of Court in winding up proceedings

1. A Court may summon before it any officer of the company or person known or suspected to have in his possession any property of the company, or supposed to be indebted to the company, or any person whom the Court considers capable of giving information concerning the trade dealings, affairs or property of the company, or examine such person on oath or require him to produce any documents in his custody or power relating to the company. Any such person not complying with the Court's order can be apprehended and brought before the Court (Sec. 195). This section deals with what is known as the *private examination* of the persons referred to therein, and is based on the practice in bankruptcy. This power is intended to be exercised for the benefit of the persons interested in winding up, but it is discretionary.

2. When the official liquidator alleges fraud against any person in the promotion or the formation of a company, or by any

director or officer of the company since its formation, the Court may, after consideration of the application in which such an allegation is made, direct the persons against whom fraud is alleged to be *publicly examined* on those matters in respect of which the fraud is said to have been committed. The official liquidator, any creditor, or contributory, and the person examined are all permitted to have legal assistance in regard to such examination. The person examined is permitted to explain or qualify any answers given by him and the evidence thus given can be used against him in civil proceedings (Sec. 196). It may be noted that while an examination under Sec. 195 is for the purpose of enabling the creditor to obtain information which may be just and beneficial for the winding up, the examination under Sec. 196 is made for the purpose of investigating into the conduct of such persons as are charged by the official liquidator with fraud.

3. A Court may order any contributory to be arrested, and his books, papers and movable property to be seized and safely kept, if it has reason to believe that he is about to leave British India, or otherwise abscond, or remove or conceal any of his property with a view to evade payment of calls, or avoid public examination.

*Note :—*Sec. 198 lays down that the Court can exercise all the above powers in addition to, and not in restriction of its existing powers to institute proceedings against any contributory, or debtor or their estate for recovery of any call or other sums (Sec. 198). It is thus clear that the powers exercised by the liquidator and the Court in compulsory winding up are of a special nature and available in addition to those under general law. It may be noted that an appeal is provided against orders passed, or decisions made, in the matter of the winding up of a company, as if they were passed by the Court in its ordinary jurisdiction.

### Voluntary winding up

The object of having a voluntary winding up is to settle the affairs between the company and its creditors without the intervention of the Court. Voluntary winding up as already noticed may be either (i) member's voluntary winding up, or (ii) creditor's voluntary winding up. The former is applicable to companies which have assets sufficient to pay off their liabilities in

full, while the latter applies to companies which are insolvent, in the sense that the assets are not sufficient to pay off the liabilities in full. The other point of difference is that in the case of the former, it is the shareholders of the company in general meeting that have the controlling voice, while in the latter case the controlling power is given to the creditors. But in either case it is the shareholders who have to decide whether or not there should be a winding up.

*When a company can be voluntarily wound up :—*

A company can be wound up voluntarily :

(i) on the expiry of the period, if any, fixed for the duration of the company by the articles, or the happening of the event on the occurrence of which according to the articles the company is to be dissolved, provided the company in general meeting has passed a resolution (i. e., *ordinary resolution*) for winding up voluntarily;

(ii) if the company by *special resolution* resolves that the company be wound up voluntarily;

(iii) if the company resolves by *extraordinary resolution* that it cannot, by reason of its liability, continue its business and it is advisable to wind up. (Sec. 203).

*Effect of voluntary winding up :—*

The expression '*resolution for voluntary winding up*' means any of the three aforesaid resolutions. The commencement of voluntary winding up will not operate as stay of proceedings, nor will it prevent the institution of new proceedings against it. The liquidator in voluntary winding up stands in the position of an agent of the company, and is not an officer of the Court, though he has to perform statutory duties and may be liable in the event of his neglect of the same. A voluntary winding up shall be deemed to commence at the time of the passing of the resolution for voluntarily winding up (Sec. 204). When a company is wound up voluntarily it shall, from the commencement of winding up, cease to carry on its business, except so far as may be required for the beneficial winding up thereof, but the corporate status and powers shall, notwithstanding the articles to the contrary, continue until it is dissolved (Sec. 205). The directors however cease to function except in so far as their powers are continued by the



liquidator. When a company passes a special or extraordinary resolution for voluntarily winding up, the company shall give notice of the same within 10 days of its passing by advertisement in the Local Official Gazette.

*Member's and Creditor's voluntary winding up :—*

A winding up in which a declaration has been made and delivered as stated below is referred to as a *member's voluntary winding up*, while a winding up in which such a declaration has not been made and delivered, is referred to as *créditor's voluntary winding up*.

The declaration which should be filed in the case of member's voluntary winding up should state that in the opinion of the directors the company will be able to pay its debts in full within a period not exceeding three years from the commencement of winding up. This should be made by all the directors, or by a majority of them, if more than two, at their meeting held before the date on which the notices of the meeting at which the resolution for the winding up of the company is to be proposed or sent out, and it should be duly verified by an affidavit that they have made a full enquiry into the affairs of the company before forming that opinion. Such a declaration shall be supported by a report of the company's auditors on the company's affairs, and the declaration and the auditor's report must be filed with the registrar for registration before the date referred to above (Sec. 207). When such a declaration has been made and registered the procedure to be followed will be the procedure for "Member's voluntary winding up."

Secs. 208-A to 208-E deal with member's voluntary winding up, while Secs. 209-A to 209-H deal with creditor's voluntary winding up. S. 211 to 220 deal with both kinds of voluntary winding up. Sec. 208-C to 208-E and 209-F to 209-H are almost similar and hence they will be considered along with the Secs. 211 to 220, which are common to both kinds of voluntary winding up.

**Member's voluntary winding up**

Sec. 208-A to 208-E both inclusive apply to a member's voluntary winding up (Sec. 208). The company in general meeting shall appoint one or more liquidators for the purpose of winding up the

affairs and distributing the assets of the company and may fix the remuneration to be paid to him or them. On the appointment of a liquidator all the powers of directors shall cease, except so far as the company in general meeting, or the liquidator, sanctions the continuance thereof. (Sec. 288-A). If a vacancy occurs in the office of the liquidator by death, resignation or otherwise, the company in general meeting may, subject to any other arrangement with its creditors, fill the vacancy. For this purpose a general meeting may be convened by any contributory, or if there are more than one liquidator, by the continuing liquidators in accordance with the articles, or as shall be determined by the Court.

#### Creditor's voluntary winding up

The provisions contained in 209-A to 209-H apply to creditor's voluntary winding up (Sec. 209). The company shall cause a meeting of its creditors to be summoned for the day or the day next to it on which there is to be held the meeting for passing the resolution for voluntary winding up. The company shall cause notice of the said meeting of creditors to be sent to the creditors simultaneously with the notices of the said meeting of the company. The company shall also cause the notice of the creditors meeting to be advertised by publication in the Gazette. The directors of the company shall lay before the said meeting of the creditors a full statement of the position of the company's affairs, together with a list of company's creditors and the estimated amount of their claims. One of the directors appointed by them shall preside at the said meeting. A resolution passed at the said meeting of the creditors shall be valid even if the resolution of the company for winding up in its general meeting was passed not on the date originally fixed for the meeting, but at an adjourned meeting. A default in compliance with the above provisions relating to creditors' meeting is made punishable (Sec. 209-A).

The creditors and the company shall at their respective meetings mentioned in Sec. 209-A nominate a person to be a liquidator for the purpose of winding up, and if the creditors and the company nominate different persons, the person nominated by the creditors shall be the liquidator, and if no person is nominated by the creditors, the one nominated by the company shall be the liquidator. Where different liquidators are nominated by the

creditors and the company, any director, member or creditor, may within seven days after the nomination was made by the creditors apply to the Court for an order to vary the appointment. The Court may thereupon : (i) confirm the appointment by the creditors, (ii) appoint the nominee of the company to act as liquidator, either singly or jointly with the creditors' nominee, or (iii) appoint a third person as liquidator (Sec. 209-B). The creditors may decide at the meeting referred to in Sec. 209-A or subsequently, if they think fit, appoint a *committee of inspection* consisting of not more than five persons. If such a committee is appointed, the members may also appoint their nominees *not exceeding five* in number to act as members of the said committee of inspection. If the creditors by a resolution hold that some amongst the nominees of the company ought not to be members of that committee, they shall not be qualified to act as such members. The Court may however on an application confirm the nomination of all or any of nominees of the company, or appoint others in their place. (Sec. 209-C). The remuneration of the liquidator shall be fixed by: (i) the committee of inspection, or (ii) if there is no such committee, by the creditors, or (iii) if not fixed by either of them, by the Court. On the appointment of a liquidator all the powers of the directors shall cease except so far as the committee of inspection, or if there is no such committee, the creditors sanction the continuance thereof (Sec. 209-D). If a vacancy in the office of liquidator, other than a liquidator appointed by or by the direction of Court, occurs by death, resignation or otherwise, the creditors may fill that vacancy.

*Procedure applicable to both kinds of voluntary winding up :—*

Secs. 211 to 218 apply to every voluntary winding up, whether it be a member's or creditor's winding up (Sec. 210). The property of a company shall, on its winding up, subject to the provision, of the Act relating to preferential payments, be applied: (i) in satisfaction of its liabilities *pari passu*, and (ii) subject to such application shall be distributed amongst the members according to their rights and interests in the company unless the articles otherwise provide (Sec. 211). Sec. 212 deals with the powers and duties of liquidators in voluntary winding up, and it shall be considered under the heading of the powers of liquidators. If for any cause there is no liquidator functioning the Court may appoint one. The liquidator appointed by mem-

bers or creditors may for sufficient cause be removed by the Court, and it may appoint another liquidator. (Sec. 213). The liquidator shall within 21 days of his appointment deliver to the registrar a notice of the appointment, and in default be liable to pay fine, (Sec. 214). The liquidator should summon a general meeting of the company at the end of the first year from the commencement of winding up and of each succeeding year, or as soon thereafter as may be convenient, within 90 days of the close of the year, and shall lay before the meeting an account of his acts and dealings, and of the conduct of winding up during the preceding year, and a statement in the prescribed form with respect to the position of the liquidation. (Sec. 208-D and Sec. 209-G).

Soon after the affairs of a company are fully wound up the liquidator shall make up an account of the winding up showing how the winding up has been conducted, and the company's property been disposed off. He shall then call a general meeting of the company before whom he shall place the account giving the necessary explanation. The meeting shall be called by advertisement in the Gazette one month before the date of meeting. The liquidator shall send to the registrar a copy of the said account, and make a return to him of the holding of that meeting, within a week after it is held. If the quorum for the meeting is wanting, that fact shall be informed to the registrar, who shall register the said account and the return, and on the expiration of 3 months after the said registration, the company shall deem to be dissolved. The Court may however defer the date of dissolution of the company for such time as it thinks fit. The person at whose instance the date of dissolution is deferred, shall within 21 days after the order of the Court deliver a certified copy of the same to the registrar for registration (Sec. 208-E and 209-H). The dissolution of the company thus made is final, unless it is declared to be void by the Court, on an application by the liquidator, or any other interested person, within 2 years from the date of dissolution. Once the dissolution is declared to be void, proceedings can be taken against the company as if it had not been dissolved. The person obtaining such a declaration must file with the registrar a certified copy of the order (Sec. 243). This exceptional power given to the Court to declare the dissolution already made void is discretionary, and it may be

exercised: (i) where fraud is proved, or (ii) where liquidator realises assets after the company is dissolved, or (iii) where the scheme or reconstruction could not be gone through.

*Note :—*The liquidator, or a contributory, or a creditor may apply to the Court to determine any question arising in the winding up, or to exercise its powers in respect of enforcing calls, staying proceedings etc., and the Court may exercise all or any of its powers, as if the company were being wound up by it. The Court may also set aside any attachment or execution against the property of the company after the commencement of winding up, (Sec. 216). The costs, charges and expenses incurred in the winding up, and the remuneration of the liquidator shall, subject to the rights of creditors, be paid out of the assets of the company in priority to all other claims (Sec. 217). The voluntary winding up of a company shall not bar the right of any creditor or contributory to have it wound up by the Court. But if such an application is made by a contributory, the Court must be satisfied that the rights of the contributories will be prejudiced by a voluntary winding up (Sec. 218).

*Effect of arrangement with creditors :—*

Sec. 215 contains provisions in regard to arrangements entered into between a company and its creditors applicable to companies in the course of either kind of voluntary winding up. It lays down that any such arrangement shall, subject to the right of appeal be binding : (i) on the company, if it is sanctioned by an extraordinary resolution, and (ii) on the creditors, if acceded to by  $\frac{3}{4}$  in number and value of the creditors. The arrangement may however be amended, varied or confirmed by the Court on an appeal to it within 3 weeks from the completion of the arrangement (Sec. 215).

### Amalgamation and Reconstruction

Sections 153-A and 153-B, as already noticed, deal with amalgamation and reconstruction of companies when they are going concerns (*supra*). Sometimes companies find that their object clauses are too limited, or that they cannot deal with certain matters with their existing constitution, and in order to overcome these difficulties they resort to what is called *reconstruction* or *amalgamation*, and for that purpose go into

**voluntary liquidation.** In such cases the liquidator should have power to transfer the whole or part of the company's property by accepting shares, debentures, policies or like interests in the transferee company, for distribution amongst the members of the transferor company. Such a power is conferred by Secs. 208-C and 209-F in the case of member's or creditor's voluntary winding up respectively.

*Power of liquidator to accept shares etc., as consideration for sale of company's property :—*

Sec. 208-C provides as follows :

“(1) Where a company is (i) proposed to be, or is in the course of being wound up altogether voluntarily, and (ii) the whole or part of its business or property is proposed to be transferred or sold to another company, whether a company within the meaning of this Act or not (in this section called “transferee company”) (iii) the liquidator of the first mentioned company (in this section called “the transferor company”) may (iv) *with the sanction of a special resolution of that company* conferring either a general authority on the liquidator, or an authority in respect of any particular arrangement (v) receive in compensation or part compensation for the transfer or sale, shares, policies or other like interests in the transferee company (vi) for distribution among the members of the transferor company or (vii) may enter into any other arrangement whereby the members of the transferor company may in lieu of receiving cash, shares, policies or other like interests or in addition thereto, participate in the profits of or receive any other benefit from the transferee company.

(2) Any sale or arrangement in pursuance of this section shall be binding on the members of the transferor company.

(3) If any member of the transferor company who did not vote in favour of the special resolution express his dissent therefrom in writing addressed to the liquidator, and left at the registered office of the company within 7 days after the passing of the special resolution, he may require the liquidator either to abstain from carrying the resolution into effect or to purchase his interest at a price to be determined by agreement or by arbitration in manner hereafter provided.

(4) If the liquidator elects to purchase the member's interest, the purchase money must be paid before the company is dissolved, and be raised by the liquidator in such manner as may be determined by special resolution.

(5) A special resolution shall not be invalid for the purposes of this section by reason that it is passed before or concurrently with a resolution for voluntary winding up or for appointing liquidators, but if an order is made within a year for winding up the company by or subject to the supervision of the Court, the special resolution shall not be valid unless sanctioned by the Court.

(6) The provisions of the Indian Arbitration Act 1940 other than those restricting the application of the Act in respect of the subject matter of the arbitration shall apply to all arbitrations in pursuance of this section."

*Note :—*The small Roman numerals in sub-section (1) above are mine. The provisions of S. 208-C as noted above apply in the case of a creditor's voluntary winding up also, but the powers of the liquidator shall not be exercised except with the sanction either of the Court or of the committee of inspection. These schemes of arrangement for amalgamation or reconstruction unlike those under S. 153-A and 153-B can be carried out without the intervention of the Court.

### **Winding up subject to Supervision of Court**

When a company is being wound up voluntarily the Court will not ordinarily have anything to do with the winding up, though its aid may be invoked by the liquidator or creditor or contributory by an application under Sec. 216. Sometimes such a course may be found to be inconvenient and it then becomes desirable and necessary to bring winding up proceedings within the control of the Court. This may be done either by an order superseding the voluntary winding up, or by obtaining what is called a *supervision order*. The power of the Court to make a supervision order is dealt with by Sec. 221. It lays down that when a company has, by special or extraordinary resolution, resolved to wind up voluntarily the Court may make an order that the voluntary winding up shall continue, but subject to such supervision of the Court, and with such liberty for creditors, contributories, or others to apply to the Court, and generally on such terms

and conditions as the Court thinks just. A supervision order, it may therefore be noted, differs from an order for compulsory winding up, in that the former continues to be a voluntary winding though the Court exercises supervision and powers of making calls, enforcing calls, etc. Further there must be a valid voluntary winding up, before there can be a supervision order. The Court would not pass the supervision order unless it is satisfied that the shareholders are likely to be prejudiced otherwise, or that some benefit would result from compulsory winding, but which could not be obtained on account of the winding up being voluntary. Thus in the following cases, the Court may pass a supervision order :—(i) partiality of the liquidator, (ii) negligence on the part of the liquidator in realising the assets ; (iii) non-observance of the rules of liquidation ; (iv) where the winding up resolution has been obtained by fraud.

### Advantages of Winding up subject to Supervision

The advantages in the case of winding up subject to supervision order are as follows :—

(1) the liquidator may, subject to any restrictions imposed by the Court, exercise all his powers as in a voluntary winding up, without the intervention of the Court (Sec. 225) ;

(2) the Court cannot order public examination of the company's officers under Sec. 196 (Sec. 225);

(3) the supervision order will operate as a stay of all suits and proceedings of the company (Sec. 222);

(4) no proceedings can be initiated or continued against the company without the leave of the Court;

(5) an additional liquidator can also be appointed (Sec. 224).

(6) the Court can make calls, or enforce calls made by the liquidators, and exercise all other powers it possesses in a winding up by the Court (Sec. 225);

(7) all acts which the Court can empower an official liquidator to do, may be directed to be done by a liquidator subject to supervision (Sec. 225).

The Court may in deciding between a winding up by the Court, and a winding up subject to supervision, in the appointment of the liquidators, and in all other matters relating to winding up subject to supervision, have regard to the wishes of the creditors, or contributories as proved by sufficient evidence (Sec. 223). In



the case of winding up subject to supervision the Court may, by the same or subsequent order, appoint an additional liquidator, who shall have the same powers and be subject to the same obligations as if he had been appointed by the company. The Court may remove any liquidator appointed by it, or any liquidator continued under the supervision order, and fill any vacancy caused by removal, death or resignation. (Sec. 224).

The liquidator in a winding up subject to supervision may, subject to the restrictions imposed by the Court, exercise all his powers without the sanction of the Court, as if the company is being wound up altogether voluntarily (Sec. 225). Where an order for winding up by the Court has been made after an order for winding up subject to supervision, the Court may appoint the voluntary liquidators or any of them, with or without the addition of any other person, to be the provisional or permanent official liquidators, in the winding up by the Court (Sec. 226).

### Consequences of winding up

It may conveniently be considered under the following heads :—(1) As to shareholders; (2) As to creditors; (3) As to dispositions by the company; (4) As to officers of the company; (5) As to servants of the company; (6) Miscellaneous consequences.

### Consequences as to shareholders

The shareholders of a company are liable to pay the nominal amount of the share capital so long as the company is a going concern, and this liability continues even after the company goes into liquidation. After the liquidation has commenced, a shareholder will be called a *contributory*, and his rights and obligations and his status undergo a change. It is the duty of a liquidator to prepare lists of contributories.

*Contributories* :—The term contributory means every person liable to contribute to the assets of a company in the event of its being wound up. In all proceedings for determination of the persons who are to be deemed contributories, the word contributory includes any person alleged to be a contributory (Sec. 158). It may therefore be noted that it is not everyone who owes money to the company that is a contributory, but only those who are liable to contribute to the company's assets in the event of its being

wound up. Sec. 156 lays down that every past and present member shall be liable to contribute to the assets of the company an amount sufficient for payment of its debts and liabilities, and the costs, charges and expenses of the winding up, and for the adjustment of the rights of the contributories among themselves. This liability of the contributory is subject to the following qualifications :—

(1) a past member cannot be made liable if he ceased to be a member for one year or upwards before the commencement of the winding up;

(2) a past member cannot be made liable for debts contracted after he ceased to be a member;

(3) a past member can be made liable only if it appears to the Court that the existing members are unable to satisfy the contributions required to be made by them;

(4) in the case of a company limited by shares, any member past or present cannot be required to contribute an amount exceeding the amount if any unpaid on the shares;

(5) in the case of a company limited by guarantee the amount of contribution required cannot exceed the amount undertaken by the member;

(6) if a company limited by guarantee has a share capital, a member shall be liable to contribute an amount not exceeding the amount guaranteed as well as the amount unpaid on the shares.

According to this section the list of contributories that has to be prepared is divided into two parts :

(i) those who are members on the date of the winding up—called *A list* and

(ii) those who have ceased to be members within a year before the commencement of the winding up—called *B list*.

### Nature of liability of contributory

Sec. 159 lays down that the liability of a contributory shall create a debt payable at the time specified in the calls made on him by the liquidator, that is, that it will be a debt which becomes payable only when a call is made by the liquidator and on the dates specified in the calls. Till the call is made it is a *debitum-in-presenti* (a present debt) but *solvendum in futuro* (payable only in future). The practical effect of this section is that the liquidator will have a fresh cause of action to realise the unpaid call money even if the company's right to realise it is barred by limitation. With regard to other claims of the company,

whether against contributories, or outsiders, there is no revival of cause of action and the period of limitation which commences against the company, continues to run against the liquidator. (Sec. 159). If a contributory dies, his legal representatives shall be liable to contribute to the assets of the company, and if they commit default the estate of the deceased can be made liable for the same. The surviving coparceners of a contributory who was a member of a joint Hindu family shall be deemed to be his legal representatives (Sec. 160). If a contributory is adjudged insolvent, the official receiver or official assignee, as the case may be, shall represent him in the winding up proceedings.

We have already noticed that a contributory cannot ordinarily set off against the amount of calls, any amount due to him from the company (*supra*). As regards the liability of a director with unlimited liability, see Sec. 157 (*supra*). We have also noticed that the liability of contributories is generally enforced by calls made by the liquidator with the sanction of the Court, if it is a winding up by the Court, and without that sanction if it is a voluntary winding up. The right to recover it by way of suit is also available.

Another change in the rights of a shareholder brought about by the winding up is with regard to his right to transfer shares etc. Sec. 227 enacts that a transfer of shares, and every alteration in the status of the members, after the commencement of voluntary winding up, made without the sanction of the liquidator, shall be void. In the case of a company which is being wound up by the Court or under its supervision, any transfer of shares or other disposition of property of the company, or alteration in the status of the members made after the commencement of the winding up shall be void, unless the Court orders otherwise. It may however be noted that there is no such restriction with regard to transfer of debentures.

## 2. Consequences as to Creditors

We have noticed that a company may be wound up when it is solvent as well as when it is bankrupt. In either case the assets must be realised and the liabilities paid off, and the surplus be distributed among the shareholders. Secs. 228 and 229 lay down

the rules in that regard, with respect to solvent and insolvent companies respectively. According to Sec. 228 in every winding up, other than of an insolvent company: (i) all debts payable on a contingency, (ii) all claims against the company present or future, certain or contingent, shall be admissible to proof against the company. Where the debt or claim is subject to any contingency, or do not bear a certain value, a just estimate of the same to the extent possible may be made. It may be noted that this section applies to a solvent company, whatever might be the mode of winding up, and that even contingent debts are permitted to be proved, however difficult it may be, in order to work out the rule of payment of the creditors *pari-passu*. Thus every liability of a company however difficult of valuation is provable in the winding up, unless declared by the Court as "incapable of being fairly estimated". In the winding up of an insolvent company the same rules shall prevail and be observed with regard to: (i) the respective rights of secured and unsecured creditors, and (ii) to debts which are proveable, and (iii) to the valuation of annuities and future and contingent liabilities, as are applicable according to the law of insolvency, in respect of the estate of a person adjudged as an insolvent. All persons who can figure as creditors and prove their debts and receive dividends out of the assets of the company may come in under the winding up, and make such claims against the company as they will be entitled to under the law of insolvency (Sec. 229). This section in effect applies the law of insolvency applicable to individuals, to the winding up of an insolvent company. Accordingly the Court fixes a time within which the creditors should prove their debts, failing which they would lose the benefit of any distribution made before those debts are proved.

It may be noted that the rights of a secured creditor are not affected by the winding up of a company, and he is therefore not governed by the rules laid down in Sec. 228 or Sec. 229. A secured creditor, except in the case of a floating charge, stands outside the winding up and his security remains unaffected. As in the case of an insolvent individual a secured creditor has got more than one right viz., (i) he may enforce his security ignoring the winding up proceedings, or (ii) he may value his security and prove for the balance of the debt like an unsecured

creditor, or (iii) he may surrender his security and prove for the entire debt due to him like an unsecured creditor.

In the case of *unsecured creditors* of insolvent companies the payments are made in the following order : (i) preferential payments as enumerated in Sec. 230, (ii) other debts *pari-passu*, and (iii) after payment of preferential and other creditors in full, the balance if any to be distributed amongst the members, according to their rights and interests in the company, unless the articles otherwise provide.

### Preferential payments

Sec. 230 gives a list of the preferential payments which are entitled to priority over other debts. They are: (i) all revenue, taxes etc., payable to the Crown, or to a local authority within 12 months before the date of the commencement of the winding up; (ii) wages or salary due to a clerk, or servant, for services rendered to the company within 2 months prior to the commencement of winding up, but subject to a limit of Rs. 1,000 for each clerk or servant; (iii) the wages of any labourer or workman for services rendered within two months before commencement of winding up subject to a limit of Rs. 500 each; (iv) compensation payable under the Workman's Compensation Act 1923 to any officer or employee of the company; (v) all sums due to an employee from the provident fund, pension fund, gratuity fund or any other fund maintained by the company for the welfare of the employees; (vi) the expenses of any investigation held under Sec. 138.

These preferential payments shall rank equally among themselves and be paid in full. Where the assets do not permit it they shall abate in equal proportion. These preferential payments shall have priority over other unsecured creditors, including the holders of debentures with floating charge. They have also priority over the right of the landlord who distrains goods within 3 months prior to the winding up. The section requires the liquidator to discharge preferential creditors without delay after retaining a sufficient sum of money for payment of costs and expenses of winding up (Sec. 230).

### 3. Consequences as to dispositions by the company

A transaction which amounts to a fraudulent preference by a company is rendered invalid, and Sec. 231 which is applicable to all cases of winding up enacts : " (1) Any transfer, delivery of goods, payment, execution or other act relating to property which would, if made or done by or against an individual, be deemed in his insolvency, a fraudulent preference, shall, if made or done by or against a company, be deemed, in the event of its being wound up, a fraudulent preference of its creditors, and be invalid accordingly. (2) For the purposes of this section the presentation of a petition for winding up in the case of winding up by or subject to supervision of the Court, and a resolution for winding up in the case of a voluntary winding up, shall be deemed to correspond with the act of insolvency in the case of an individual. (3) Any transfer or assignment by a company, of all its property to trustees for the benefit of all its creditors shall be void". The conditions that should be satisfied in order that a transaction may be declared as a fraudulent preference are the same as in the case of insolvency of an individual, viz : (i) it must have taken place within 3 months prior to the presentation of the petition in the case of winding up by or subject to supervision of the Court, or of the resolution in the case of voluntary winding up, (ii) the dominant motive for the act must be the desire to prefer the creditor to whom the payment was made, and (iii) the company must have in fact preferred that creditor.

We have already noticed that a floating charge created within 3 months prior to the commencement of winding up shall, unless it is proved that the company was at the time of creating the charge solvent, be invalid except to the amount of cash paid at the time of creation of the charge or subsequently together with interest at 5%.

### 4. Consequences as to Officers

The word officer is defined in S. 2 (11) as including any director, managing agent, manager or secretary, but does not include an auditor except for the purposes of Secs. 235 to 237. When a winding up order has been made or a liquidator is appointed in a voluntary winding up, the powers of the director cease. We have already noticed that officers can be summoned

by the Court to appear and to also bring with them any books or documents of the company and that they can be publicly examined, if there is a *prima facie* case for suspicion.

1. *Liability for misfeasance and breach of trust :—*

Sec. 235 lays down that where in the course of winding up a company, it appears that any promoter, director, manager, liquidator or officer of the company has (i) misapplied, or (ii) retained; or (iii) become liable or accountable for any money or property of the company; or (iv) been guilty of any misfeasance or (v) breach of trust in relation to the company, the Court may, on the application of the liquidator, or of any creditor, or contributory made within three years from the date of the first appointment of the liquidator in winding up, or of the misapplication, retainer, misfeasance, or breach of trust, as the case may be, whichever is longer, examine into the conduct of the said promoter, director, manager, liquidator, or officer and compel him to repay or restore the money, or property or any part thereof respectively, with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance, or breach of trust as the Court thinks just. This section shall apply notwithstanding that the offence is one for which the offender may be criminally responsible (Sec. 235).

*Note :—*This section is intended to facilitate the recovery by the liquidator of the assets of the company improperly dealt with by the directors or other officers, by providing a summary procedure for the same. Its object is not to punish a man guilty of misfeasance, but to compensate the company for the loss occasioned thereby. The remedy provided for by this section is applied in two classes of cases : (i) breach of trust (ii) misfeasance by the director or other officer of the company. The word *misfeasance* is defined to mean "misfeasance in the nature of a breach of trust, that is to say, it refers to something which the officer of such company has done wrongly by misapplying or retaining in his own hands any monies of the company, or by which the company's property has been wasted, or the company's credit improperly pledged." The following have been held to be instances of misfeasance : (i) making secret profits and illegitimate gains, (ii) payment of dividends out of capital,

(iii) taking bribes and commissions, (iv) paying company's funds for purposes which are ultra vires, (v) directors taking undue remuneration or showing undue favour to themselves. The section deals only with procedure but does not confer any new rights, and the discretion of the Court to grant or refuse relief under it is sufficiently wide.

(2) If any director, manager, officer or contributory of a company which is being wound up, destroys, mutilates, alters or fraudulently secretes any books, papers or securities, or makes, or is privy to the making of any fraudulent entry in any register, book of account, or document belonging to the company with intent to defraud or deceive any person, he shall be liable to imprisonment which may extend to seven years (Sec. 236).

(3) Sec. 237 lays down the procedure for prosecuting delinquent directors and other officers, in the case of companies which are being wound up by or subject to supervision of the Court, as well as those being voluntarily wound up.

(4) Sec. 238 provides penalty for false evidence.

(5) Sec. 238-A provides fine and imprisonment for a variety of offences committed by directors or other officers of companies in liquidation, either prior to or in the course of winding up.

### 5. Consequences as to Servants

According to Sec. 172 (3) a winding up order shall be deemed to be notice of discharge to the servants of the company, except when the business of the company is continued. In cases where a servant of the company is under a contract of service for a specified time, which has not expired on the date of winding up, the order of winding up shall operate as a breach of contract for service, and if there is a restrictive covenant preventing the servant from carrying on business competing with that of the company, the termination of his services on account of winding up would release him from that covenant. A voluntary winding up also operates in most cases as discharge of the company's servants.

### 6. Miscellaneous consequences of winding up

According to Sec. 217 all costs, charges and expenses properly incurred in winding up, including the remuneration of the



liquidator shall, subject to rights of secured creditors, if any, be payable out of the assets of the company in priority to all other claims. Sec. 232 provides that where a company is being wound up by or subject to supervision of the Court, any attachment, distress, or execution put into force against the estate of the company without the leave of the Court, or any sale of the company's property, held without the leave of the Court, after the commencement of the winding up shall be void. The proceedings by the Government however are not affected by this section. The documents of the company and of liquidators shall, as between the contributories of the company, be prima facie evidence of the truth of all matters therein recorded. After an order for winding up, by or subject to supervision of the Court, it may make an order for inspection of its documents by the creditors, or contributories (Sec. 241). Sec. 242 provides for the disposal of company's documents after it has been wound up and is about to be dissolved. The power of the Court to declare void, a dissolution already made has been considered (*supra*). Sec. 194 deals with dissolution of a company, and Secs. 208-E and 209-H provide for the final meeting and dissolution when the affairs are fully wound up.

### Liquidators

In every winding up a liquidator must be appointed. The manner in which a liquidator should be appointed, and the powers that can be exercised by him depend on the mode of winding up, and they will now be considered with respect to each mode of winding up.

#### 1. On a winding up by the Court

*Appointment of liquidator:*—Sec. 170 (3) provides that the Court while making an order for winding up of a company, shall, except where a liquidator is appointed simultaneously, forthwith cause intimation thereof to the official receiver, who shall become the official liquidator, and continue to act as such, until his further continuance is terminated by an order of the Court. The official receiver shall as official liquidator forthwith take into his custody and control all books and documents and assets of the company (Sec. 171-A). The object of these sections is to see that the properties of a company in liquidation are taken charge

of by a responsible officer of the Court, be he a provisional liquidator or the official receiver. Sec. 175 lays down that for the purpose of conducting the proceedings in winding up a company, and performing the necessary duties, the Court may appoint one or more persons other than the official receiver to be called official liquidator or official liquidators. Such appointment may be provisionally made at any time after the presentation of the petition, and before making an order for winding up. Before making any such appointment the Court shall give notice to the company. If more than one liquidator are appointed, the Court shall declare whether any particular act is to be done by all, or by any one or more of the liquidators so appointed. The Court may determine what security is to be furnished by the official liquidator. The acts of the official liquidator shall be valid notwithstanding any defect that may afterwards be discovered in his appointment, but the acts of an official liquidator, after his appointment has been shown to be invalid, shall not be deemed to be valid. A receiver shall not be appointed in respect of assets in the hands of an official liquidator. It may be noted that an official liquidator is different from an official assignee or official receiver, in that the property of a company does not vest in the official liquidator, while the property of an insolvent vests in the official assignee, or official receiver, as the case may be. An official liquidator is not strictly speaking a trustee. He is the representative of the creditors for some purposes, and of contributories for other purposes. He however occupies a fiduciary position, and the assets in his hands are *custodia leges* (in the custody of the Court).

*Resignation, removal and filling up of vacancy of liquidator :—*

An official liquidator may resign or be removed by the Court. In the case of any vacancy occurring in the office of an official liquidator, the Court shall appoint another, and till then the official receiver shall be, and act as the official liquidator. The Court shall determine the remuneration to be paid to the official liquidator by way of percentage or otherwise, and shall fix the proportion in which it is to be distributed between the liquidators, if there are more than one (Sec. 176). He shall be described by the style of the official liquidator of the particular company for which he is appointed, and not by his individual name. It is

his duty, whether appointed provisionally or not, to take into his custody all property, effects and actionable claims of the company, and all property of the company shall be deemed to be in the custody of the Court from the date of the order for winding up.

*Statement of affairs to be made to the liquidator :—*

An official liquidator is entitled to receive a statement as to the affairs of the company duly verified by an affidavit and containing the following particulars :—

- (i) the assets of the company stating separately the cash balance in hand and at the bank ;
- (ii) debts and liabilities ;
- (iii) names and addresses of the creditors with particulars of the nature and amounts of debts due etc ;
- (iv) the debts due to the company with particulars of the debtors, amounts due etc.

This statement has to be submitted duly verified by one or more directors, and by the manager, secretary, or other chief officer of the company. The official liquidator may, subject to the directions of the Court, require such statement to be submitted or verified by : (i) past or present directors or officers of the company, or (ii) those who took a part in the formation of a company at any time within the relevant date, or (iii) the past or present employees of the company within the said year, or (iv) the past or present officers of the company in the year to which the statement relates.

The statement should be submitted within 21 days from the relevant date, or within the time extended by the official liquidator or by the Court. The expenses for preparing the statement may be paid out of the assets of the company by the official liquidator to the persons making it. Default in compliance with the provisions is made punishable. The said statement can be inspected by the creditors or contributories of the company at all reasonable times. The expression "relevant date" in this section means, in a case where a provisional liquidator is appointed, the date of his appointment, and where no such appointment is made the date of winding up order [Sec. 177-A].

*Statement by liquidator :—*

The official liquidator shall, as soon as practicable, after receipt by him of the statement under Sec. 177-A, and not later

than four or with the leave of the court not later than six months from the date of the winding up order, or where the Court orders that no statement under Sec. 177-A need be submitted, as soon as practicable after the date of the order, submit a preliminary report to the Court containing the following particulars :

1. the amount of capital, issued, subscribed and paid up, and the estimated amount of assets and liabilities giving separately the following particulars with regard to assets viz : (i) cash and negotiable instruments, (ii) debts due to contributories, (iii) debts due and securities if any available to the company, (iv) movable and immovable properties belonging to the Company, (v) unpaid calls;

2. if the company has failed, the causes of such failure;

3. whether in the opinion of the liquidator further enquiry is desirable as to any matter relating to promotion, formation, or failure of the company or the conduct of the business thereof.

The official liquidator may also, if he thinks fit, make a further report stating the manner in which the company is formed, and whether in his opinion any fraud is committed by any person in its promotion or formation, or by any director or other officer of the company in relation to it since its formation, and any other matters which in his opinion it is desirable to bring to the notice of the Court (Sec. 177-B).

### Committee of Inspection

Within one month from the date of the order for winding up, the official liquidator shall convene a meeting of the creditors of the company for the purpose of determining : (i) whether or not a committee of inspection shall be appointed to act with the liquidator, and (ii) who are to be the members of such committee. Within a week from the date of the creditors' meeting the official liquidator shall convene a meeting of the contributories to consider the decision of the creditors and to accept the same with or without modifications. If the contributories do not accept the decision of the creditors in its entirety the official liquidator should apply to the Court for directions as to whether : (i) there shall be a committee of inspection, and if so (ii) what shall be the composition of the committee, and (iii) who shall be the members thereof.

A committee of inspection thus appointed shall consist of not more than 12 members who are creditors and contributories of

the company, in such proportion as may be agreed on by the meetings of creditors and contributories. In case of difference between them, the proportion shall be determined by the Court. The committee of inspection shall have (i) the right to inspect the accounts of official liquidator, and (ii) meet at least once a month or more often if necessary, and shall act by majority of the members present at a meeting, which shall not act unless a majority of the committee are present. The official liquidator or any member of the committee may also call a meeting of the committee. A member of the committee may resign his office, and he shall have to vacate his office if he : (i) becomes bankrupt ; or (ii) compounds or arranges with his creditors; or (iii) absents himself for five consecutive meetings of the committee without its leave. A member of the committee may be removed by an *ordinary resolution* at a meeting of creditors or contributories, according as he represents the former or the latter. Whenever a vacancy occurs in the committee, it may be filled by the creditors or contributories by re-appointing him, or appointing another creditor or contributory as the case may be. A committee can act provided the number of its members is not less than two (Sec. 178-A). This section has been added by the amendment Act of 1936.

### Powers of Official Liquidators

The official liquidator shall have the power to do the following acts with the sanction of the Court :

(i) institute or defend any suit, or prosecution, or other legal proceedings on behalf of the company ;

(ii) carry on company's business, to the extent it is beneficial for winding up of the company ;

(iii) sell or transfer the immovable or movable property by public auction or private sale ;

(iv) to execute all deeds and other documents on behalf of the company and use the company's seal ;

(v) figure as a creditor in the event of a contributory's insolvency and realise the amount due from him ;

(vi) to draw, accept, make, and endorse negotiable instruments in the name and on behalf of the company ;

(vii) to raise loans on the security of the company's assets ;

(viii) to take out letters of administration to any deceased contributory and to do other acts for realising the amount due from him ;

(ix) to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets. (Sec. 179).

**Note :—**An official liquidator being an officer of the Court cannot exercise these powers without an order of the Court. The absence of sanction in regard to any legal proceedings is however a matter between him and the Court and neither a third party nor a Court in which the proceedings are pending has any concern with it. But the official liquidator may lose his indemnity for anything done in connection with a legal proceeding without the sanction of the Court. The Court may by an order confer general authority to exercise all or any of the above powers without its previous sanction, and may likewise restrict the powers in the case of the provisional liquidator by the order appointing him (Sec. 180). An official liquidator may with the sanction of the Court engage an advocate or pleader to appear on his behalf before the Court to assist him in the performance of his duties. (Sec. 181).

### Duties of Official Liquidators

In addition to exercising the powers enumerated above, an official liquidator has to discharge the following duties :

(i) keep proper books in which he shall cause to be made entries or minutes of proceedings at meetings of creditors and contributories, and such other matters, which will be liable to inspection by the creditors and contributories;

(ii) he shall present to the Court an account of receipts and payments as liquidator, twice at least every year during his tenure of office ;

(iii) the accounts must be verified and in prescribed form, and the Court shall have them audited in such manner as it thinks fit. When the accounts have been audited one copy thereof shall be filed and kept by the Court, and the other copy shall be delivered to the registrar for filing (Sec. 182);

(iv) the official liquidator shall, in the administration of the assets of the company and in its distribution among the creditors, have regard to any directions that may be given : (a) by a resolution of the creditors or contributories at any general meeting, or (b) by a committee of inspection. If any directions given by the creditors or contributories at any general meeting are in conflict with the directions given by a committee of inspection, the former shall override the latter ;

(v) the official liquidator may summon general meetings of creditors or contributories for ascertaining their wishes, and he shall also summon them whenever he is required to do so by the creditors or contributories by means of a resolution, or whenever requested to do so in writing by creditors or contributories who are 1/10th in value ;

(vi) the official liquidator may apply to the Court for directions in relation to any matter arising in winding up ;

(vii) he shall exercise his discretion in the administration of the company's assets and its distribution among the creditors.

**Note :—**Any person aggrieved by any action of the official liquidator may apply to the Court which may confirm, reverse or modify the act or the decision complained of, and make such order as it thinks just.

## II. Voluntary winding up

### (a) *Member's voluntary winding up :*

The procedure to be followed in appointing a liquidator in the case of member's voluntary winding up has already been noted (*supra*).

The powers of such liquidator are :—

(i) with the *sanction of an extraordinary resolution* of the company exercise any of the powers given to a liquidator in compulsory winding up by clauses d, e, f and h of section 179 (i.e. execution of deeds on behalf of the company, proving and ranking as a creditor in the course of contributory's insolvency, making, accepting and endorsing negotiable instruments, and taking out letters of administration to a deceased contributory). This power is subject to the control of the Court ;

(ii) without any sanction he can exercise the other powers given to the liquidator in compulsory winding up ;

(iii) exercise the powers of the Court in settling a list of contributories, which shall be *prima facie* evidence of the liability of the persons named therein as contributories ;

(iv) exercise the power of the Court in making calls;

(v) summon general meetings of the company for the purpose of obtaining its sanction by special, or extraordinary resolution, or for any other purpose;

(vi) pay the debts and adjust the rights of contributories among themselves.

**Note :—**Where more than one liquidator is appointed, the aforesaid powers have to be exercised by such one or more of them as may be determined by their appointment, and if not so determined they can be exercised by not less than two.

### (b) *Creditor's voluntary winding up :*

The method by which a liquidator can be appointed in creditor's voluntary winding up has already been noted (*supra*). The powers and duties of such a liquidator are the same as those

of a liquidator in member's voluntary winding up, except that the powers given to a liquidator in compulsory winding up by Sec. 179 clauses (d) (e) (f) and (h) can be exercised by this liquidator only with the sanction of either the Court, or the committee of inspection.

### III. Winding up subject to supervision

We have already noticed that at the time of making an order for winding up subject to supervision, the Court may by the same or subsequent order appoint any additional liquidator. Such liquidator shall have : (i) the same powers, (ii) be subject to the same obligations, and (iii) in all respects stand in the same position, as if he had been appointed by the company (Sec. 224). It is therefore needless to add that a liquidator in this kind of winding up exercises the same powers as a liquidator in voluntary winding up, unless the powers are restricted by the Court at the time of his appointment, or at the time of the supervision order.

#### Liquidator's powers to disclaim property

A liquidator in the case of every kind of winding up is given by Sec. 230-A the right to disclaim property burdened with onerous covenants, or unprofitable contracts or similar property. An onerous property for this purpose may fall under any of the following heads : (i) land of any tenure burdened with onerous covenants; (ii) shares or stocks in companies; (iii) unprofitable contracts; or (iv) any other property which is unsaleable or not readily saleable. In the case of such onerous property the liquidator may with the leave of the Court at any time within 12 months, either after the commencement of wind up, or after the existence of such property has come to his knowledge, or within such extended time as may be allowed by the Court disclaim that property. The disclaimer shall operate to determine as from the date of disclaimer all rights and interests and liabilities of the company, but shall not affect the rights or liabilities or any other person. Before granting leave to disclaim, the Court may issue notices to persons interested, and impose such conditions as it thinks just as a condition to granting leave.

The liquidator shall not be entitled to disclaim where an application in writing has been made to him by any persons interested in the property requiring him to decide whether or not



he will disclaim, and the liquidator has not within a period of 28 days thereafter, or within such period as extended by the Court, given notice to the applicant that he (liquidator) intends to apply to the Court for leave to disclaim. In the case of a contract, if the liquidator after such an application by the party interested does not disclaim within the said period, the company shall be deemed to have adopted it. The Court may on the application of any person who is entitled to the benefit, or subject to the burden of the said contract, make an order rescinding it on such terms as it thinks just. The Court may on an application by any person who claims any interest in any disclaimed property or under any liability in respect of such disclaimed property, and after hearing such persons as it think fit, make an order for the vesting of the property in, or delivery of property to, any persons entitled thereto, or to whom it may seem just that the property should be delivered, and the property shall vest accordingly in such persons without conveyance or assignment for the purpose. Where the property disclaimed is of a leasehold nature the Court shall at the time of the vesting order make it subject to the same liabilities and obligations as those to which the company was subject under the lease. Any person injured by the operation of disclaimer under this section shall be deemed to be a creditor of the company to the amount of injury, and may accordingly prove the amount as a debt in the winding up (Sec. 233-A).

### Other duties of liquidators

When a company is being wound up and the winding up is not concluded within one year after its commencement, the liquidator shall once in each year and at intervals of not more than 12 months, until winding up is concluded, file into Court or with the registrar, as the case may be, a statement in the prescribed form, and containing the particulars with respect to proceedings in and position of liquidation. The said statement shall be open to inspection by creditors or contributories. Non-compliance with the provisions makes the liquidator liable to punishment. When the statement is filed into Court a copy of the same shall be filed with the registrar for being kept with the other records of the company (Sec. 244),

The liquidator of a company is required to pay the monies received by him into a scheduled bank in such manner and at such times as may be prescribed. The Court may if it thinks it is advantageous to creditors or contributories, permit the liquidator to make payments into some other banks. The liquidator shall not at any time retain for more than 10 days a sum exceeding Rs. 500 or such other amount as the Court authorises him to retain. The liquidator shall open a special banking account and shall pay all sums received by him as liquidator into such account.

### Defunct Companies

Where the registrar has reasonable cause to believe that a company is not carrying on business or in operation, he may remove the same from the register of companies after giving reasonable opportunity and ascertaining whether the company is carrying on business or not. He is also given the power to strike out from the register of companies, the names of companies in the course of winding up in which no liquidator is acting, or the affairs of which are fully wound up, and the liquidator of which has not submitted returns in accordance with the Act for a period of 6 months, even after a notice demanding the return has been sent by the registrar (Sec. 247).

### Winding up of unregistered companies

Sec. 270 defines an unregistered company as not including a railway company incorporated by an Act of Parliament, or by an Act of Governor General in Council, nor a company registered under the Indian Companies Act 1866, or under any Act repealed thereby, or under the Indian Companies Act 1882, or under the Indian Companies Act 1913, but save as aforesaid it shall include any partnership, association, or company consisting of more than 7 persons (Sec. 270). The provisions of the Companies Act with regard to winding up apply to the winding up of unregistered companies with the following modifications :—

(i) the Court having jurisdiction to wind up shall be the Court of the Province where the principal place of business of the company shall be situate and that place shall also be deemed to be the registered office of the company;

(ii) an unregistered company cannot be wound up voluntarily or subject to supervision;

(iii) it may be wound up : (a) if it is dissolved or ceases to carry on business or is carrying on business only for winding up its affairs, (b) if it is unable to pay its debts (c) if the Court is of opinion that it is just and equitable that the company should be wound up;

(iv) an unregistered company shall be deemed to be unable to pay its debts in circumstances in which a registered company is said to be unable to pay its debts, and on the additional ground that the company has not within 10 days after the service of notice in a suit or other proceeding instituted against any of its members for recovery of the debt fails to pay the same or compound the debt, or have the suit stayed or indemnify the defendant to his satisfaction (Sec. 271).

According to Sec. 272 every person liable to pay, or contribute to the payment of any debt, or liability of the company or for the adjustment of the rights of the members among themselves, or for the payment of costs and expenses of winding up the company, shall be deemed to be a contributory of the unregistered company and he shall be liable to contribute all such sums due from him as aforesaid. The provisions of the Act with regard to staying and restraining suits etc., are made applicable to the winding up of unregistered companies (Sec. 273). Sec. 274 enacts that after an order for winding up of unregistered company has been made, no suit or other legal proceedings can be started or proceeded against it, without the leave of the Court. Sec. 275 empowers the Court to give directions that all or any part of its property shall vest in the official liquidator by his official name, who shall thereupon institute or defend actions in respect of such property. Sec. 276 enacts that the aforesaid provisions shall be in addition to, and not in restriction of any provisions contained in the Act with respect to winding up of a company by the Court, and the Court or the official liquidator may exercise any powers or do any acts, in the case of unregistered companies which might be exercised or done in winding up companies registered under this Act. An unregistered company in the event of its being wound up is deemed to be a company under this Act, and even then only to the extent provided for in regard to winding up of unregistered companies.

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## CHAPTER XXII

### INSOLVENCY

*General* :—Bankruptcy or Insolvency is the proceeding by which the State takes possession of the property of a debtor by an officer appointed for the purpose, realises the property of the debtor and subject to certain priorities distributes it rateably among the persons to whom the debtor owes money, or has incurred pecuniary liabilities. The law relating to insolvency is therefore designed to meet the case of an individual who has no reasonable prospect of being able to pay his debts. Its aim is two-fold : (i) to distribute the debtor's property among the creditors in the most expeditious and economical manner, and (ii) to give the debtor a new start in life freed from the demand of his creditors, when he has not been guilty of certain serious offences (Ringwood). Before a person can be declared an insolvent he must commit an act of insolvency, that is some act which shows that it is probable that he cannot pay his debts. The law insists on proof of an act of insolvency in order to prevent solvent persons from being subject to, or having recourse to, insolvency proceedings. If an act of insolvency is committed, an insolvency petition may be presented, whereupon an interim receiver will be appointed, who will take possession of the properties of the debtor. When a Court is satisfied that all the statutory conditions have been fulfilled the debtor will be adjudged an insolvent. On the passing of the adjudication order the property of the insolvent will vest in the Official Assignee in the Presidency-towns, and in the Official Receiver in the mofussil, who will collect all his property and distribute it among the creditors who have proved their debts. The insolvent may apply for his discharge, but it may either be refused or granted depending on his conduct before and during the insolvency, and the amount of dividend available for distribution among his creditors. On discharge, the insolvent is freed from his former debts and liabilities and can recommence business.

The law relating to insolvency is the creation of statute, both in England as well as in India. In England the law is mainly to

be found in the Bankruptcy Act 1914, as amended by the Bankruptcy Amendment Act 1926, and the rules framed thereunder. In India the law is to be found in two enactments (i) the Presidency-towns Insolvency Act III of 1909, (hereafter called P. T. I. Act) which came into force on 1st January 1910, and which applies to the Presidency-towns of Calcutta, Bombay, Madras and Karachi, and (ii) The Provincial Insolvency Act V of 1920 (hereafter called P. I. Act) which came into force on 25th February 1920, and which applies to the whole of British India outside the Presidency-towns, excepting the schedule districts. Both these Acts are based on the English Bankruptcy Acts of 1883 and 1890. The Presidency Towns Insolvency Act followed the English Law more closely than the Provincial Insolvency Act, because it was felt that the conditions in the mofussil (outside the Presidency towns) did not warrant the wholesale introduction of the English Law, in those areas. Notwithstanding these statutes it has been found by Courts that the law relating to insolvency is still defective, and needs improvement in several particulars for the benefit of the creditors, and that until such time the "insolvency Court will continue to be a place of pilgrimage for debtors to enter by one door with offerings of debts for the God presiding in it and to depart at the other door, discharged from all their debts and all their sins."

Though many principles are identical, there are some important points of difference between the law as laid down in these two Acts, and they have been noted in their appropriate places. The sections cited hereafter relate to the Provincial Insolvency Act, in the absence of an express reference to the Presidency Towns Insolvency Act.

### Courts having insolvency jurisdiction and their powers

In the Presidency Towns the insolvency jurisdiction is vested in the respective High Courts. In areas outside the Presidency towns the insolvency jurisdiction is vested in the District Courts, which are the principal Civil Courts of original jurisdiction, but the local Government is empowered by notification in the local official Gazette to invest any Court subordinate to a District Court to have concurrent jurisdiction with it (Sec. 3). In fact by means of such notification the Munsif's Courts and Subordinate Judge's courts are all exercising insolvency jurisdiction to-day.

### Powers of Insolvency Courts

Subject to the provisions of the Act the insolvency Courts have full power to decide all questions, whether of title or priority, or of any nature whatsoever, and whether involving matters of law or fact which may arise in any case of insolvency coming within the cognisance of the Court, or which the Court may deem it expedient or necessary to decide for the purpose of doing complete justice, or making a complete distribution of property in any such case. Subject to the provisions of the Act and notwithstanding anything contained in any other law for the time being in force, such decision shall be final and binding for all purposes as between the debtor and the debtor's estate on the one hand, and all claimants against him or it, and all persons claiming through or under them on the other. If the insolvency Court does not deem it expedient or necessary to decide any question of title or priority, referred to above, but has reason to believe that the debtor has a saleable interest in any property, it may without further enquiry, sell such interest in such manner and subject to such conditions as it thinks fit. (Sec. 4). The insolvency Court has in regard to proceedings under the Act the same powers and shall follow the same procedure as it has, and follows in the exercise of original civil jurisdiction. The High Court and the District Courts, in regard to proceedings under this Act in Courts subordinate to them, shall have the same powers and follow the same procedure as they respectively have and follow in regard to civil suits. (Sec. 5). Thus it is made clear that the insolvency Courts have all the powers of Civil Courts, and that the provisions of the Civil Procedure Code will be applied to the insolvency proceedings except to the extent they are modified by the Act.

In *G. V. Muthuswamy Chetty v. Official Assignee of Madras*, 59 Mad. 1020 (F.B.) it was held that an application by the Official Assignee under Sec. 7 of the P. T. I. Act (which corresponds to Sec. 4 P. I. Act) was equivalent to a suit for the purposes of Sec. 3 of the Limitation Act, and that the articles of the Limitation Act applied to such an application. Accordingly it was held that mesne profits for more than 3 years prior to the application by the Official Assignee could not be claimed from the mortgagee, after the mortgage in his favour by the insolvent

was set aside. The same principle was applied in a similar application under the Provincial Insolvency Act by a bench of the same High Court in *Pathi Gudeppa v. Official Receiver Bellary*, (1945) 2 M. L. J. 557.

Under Sec. 80 the High Court, with the previous sanction of the Local Government is authorised to delegate to the Official Receiver the exercise of all or some of the following powers subject to its directions : viz., (i) to frame schedules and to admit or reject proofs of creditors; (ii) to make interim orders in any case of urgency, and (iii) to hear and determine any unopposed or *ex parte* application. Subject to the appeal to the Court provided for by Sec. 68, an order made, or an act done by the Official Receiver in the exercise of these powers shall be deemed to be the order or act of the Court. A similar power is given under S. 6 of the P. T. I. Act to the Chief Justice to delegate some of the powers of the Court to an officer of the Court, appointed for the purpose.

### Definitions

*Insolvent* : Curiously enough the word insolvent has not been defined in the Act, but an insolvent may be described as a person against whom an order of adjudication has been passed. An order of adjudication cannot however be made unless the debtor has committed one of the acts of insolvency enumerated below.

The following are some of the words defined by the Act :

*Debt* : includes a judgment debt, and a debtor includes a judgment-debtor;

*Creditor* : includes decree-holder;

*Secured creditor* : means a person holding a mortgage, charge or lien on the property of the debtor or any part thereof, as a security for a debt due to him from the debtor.

*Property* : includes any property over which, or the profits of which any person has a disposing power, which he may exercise for his own benefit. This definition of property is obviously not exhaustive. The English Bankruptcy Act (Sec. 167) defines property as including "money, goods, things in action, land, and every description of property, whether real or personal, and whether situated in England or elsewhere; also obligations,

easements and every description of estate, interest, and profit, present or future vested, or contingent, arising out of or incident to property as above defined."

• *Transfer of property* : includes a transfer of any interest in property, and the creation of any charge upon the property.

Other words used in the Act bear the same meaning as in the Civil Procedure Code.

### Proceedings from Act of Insolvency to Discharge

#### *Acts of Insolvency* :—

"A debtor commits an *act of insolvency* in each of the following cases, namely :—

(a) if, in British India or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally ;

(b) if, in British India or elsewhere, he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors ;

(c) if, in British India or elsewhere, he makes any transfer of his property, or any part thereof, which would, under this or any enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent ;

(d) if, with intent to defeat or delay his creditors,—

(i) he departs or remains out of British India,

(ii) he departs from his dwelling-house or usual place of business or otherwise absents himself,

(iii) he secludes himself so as to deprive his creditors of the means of communicating with him ;

(e) if any of his property has been sold in execution of the decree of any Court for the payment of money ;

(f) if he petitions to be adjudged an insolvent under the provisions of this Act ;

(g) if he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts ; or

(h) if he is imprisoned in execution of the decree of any Court for the payment of money ;

(i) if after a creditor has served an insolvency notice on him in respect of a decree or an order for the payment of any amount due to such creditor, the execution of which is not stayed, he does not within the period specified in the notice, which shall not be less than one month, comply with the requirements of the notice :

Provided that the debtor shall not be deemed to have committed an act of insolvency for not complying with the requirements of the notice, if he has a



counter-claim or set-off which equals or exceeds the decretal amount or the amount ordered to be paid by him and which he could not lawfully set up in the suit or proceeding in which the decree or order was made against him.

*Explanation* :—For the purposes of this section the act of an agent may be the act of the principal." (Sec. 6).

An act of insolvency may therefore result from : (i) dealings by the debtor with his property, or (ii) personal acts or defaults by the debtor, or (iii) the condition of his affairs showing him to be an insolvent. The cases enumerated in Sec. 6 clauses (a) (b) and (c) above fall within the first, while clause (d) falls within the second, and clauses (e) (f) (g) and (h) under the third category respectively. In order that a transfer of a debtor's property may amount to a fraudulent preference within the meaning of cl. (c) it should be established that the debtor (i) was unable to pay his debts as they became due, and (ii) intended to give a particular creditor preference over other creditors, and (iii) with that object made the transfer voluntarily, and not on account of any pressure from that creditor. There is one point of difference between the law in the Presidency-towns and the mofussil in respect of Sec. 6, Cl. (e) noted above. According to the P. I. Act, if the property has been sold in execution of the decree of any Court for the payment of money, a debtor will be deemed to have committed an act of insolvency, but according to the P.T.I. Act (Sec. 9) it is not necessary that the property should be sold. Even if the property has been attached for a period of not less than 21 days in execution of a money decree, it will amount to an act of insolvency. Sec. 6 (f). P. I. Act makes it clear that the presentation of a petition by the debtor is itself an act of Insolvency, and it is by far the most popular act of insolvency on the strength of which debtors get themselves adjudicated as insolvents. It may be noted that the presentation of a petition does not cease to be an act of insolvency, simply because it has been dismissed.

### Insolvency Notice

The notice referred to in cl. (i) in Sec. 6 should be in the prescribed form and should be served on the debtor in the prescribed manner, stating therein that the debtor should pay the amount due under the decree or order, or furnish security for the payment of the said amount to the satisfaction of the creditor, and

also stating the consequences of non-compliance with the notice. The mere fact that the amount due to a creditor has not been correctly specified in the notice would not invalidate the same, unless the debtor takes an objection to it on that ground (Sec. 6-A).

### Petition for adjudication

The petition for adjudicating a debtor as an insolvent may be presented either by a creditor (called the *creditor's petition*) or by the debtor (called the *debtor's petition*). The presentation of a petition by the debtor shall itself be deemed to be an act of insolvency, and on such petition the Court may make an order of adjudication. (Sec. 7).

### Who may be adjudicated insolvent

Sec. 8 lays down that an insolvency petition cannot be presented against a corporation, or an association, or company, registered under any Act for the time being in force. The reason for the rule is obvious *viz.*, that a corporation or a company cannot be adjudged insolvent, and the only remedy of the creditors in the case of insolvent companies is to have them wound up by means of liquidation proceedings (*supra*). In the case of joint Hindu families carrying on business, popularly known as joint family firms, all the adult members may be adjudged insolvent, if they have committed an act of insolvency jointly. But if the other members of the family have not taken part in the business, it is only the manager carrying on the business that can be adjudged insolvent, but not the other members. It may be noted that an insolvency petition may be presented *against joint debtors* and that it may also be presented *by joint creditors*.

*Minor*: A minor cannot be adjudged an insolvent for the simple reason that all contracts by a minor in India are void. In England also he cannot be adjudicated a bankrupt. Even though the debts contracted by a minor for necessities are valid in English law, it is still doubtful whether he could be made bankrupt even in respect of such debts.

*Married Woman*:—After passing of the Law reform (*Married Women and Tort Feasors*) Act, 1935 a married woman in England can be adjudged a bankrupt, whether she carries on business or not,

*Lunatic* :—A lunatic can be adjudged a bankrupt. *In re a debtor*, (1941) Ch. 487.

*Note* : A minor through his next friend, as well as a limited company, can present a creditor's petition for adjudicating a debtor as an insolvent. It may be noted that the sons of a deceased Hindu debtor cannot be adjudged insolvents for the debts due from the father, because the sons under the circumstances are not debtors within the meaning of the Act. *Abdul Rahman Miya v. Gajendra Lal Shah* I.L.R. (1939) Cal. 132.

### Court to which petition shall be presented

An insolvency petition (whether a creditor's or debtor's application) shall be presented to a Court having jurisdiction under this Act in any local area, in which the debtor : (1) ordinarily resides, or (2) carries on business, or (3) personally works for gain, or (4) if he has been arrested or imprisoned, where he is in custody. Any objection as to jurisdiction of a Court to entertain an application should be taken at the earliest opportunity, and even where there is such an objection it cannot be allowed unless it has resulted in failure of justice (Sec. 11). A foreigner, it may therefore be noted, cannot get himself adjudged insolvent by the British Indian Courts unless on the date of the act of insolvency he is ordinarily residing, or carrying on business, or personally working for gain, within the local limits of British India. A creditor's petition cannot be filed against a debtor who is a foreigner unless the act of insolvency is done or suffered by him within the jurisdiction of the British Indian Court. According to the law in the Presidency-towns it is not necessary that the debtor should have been residing or carrying on business etc., in a local area within the jurisdiction of the Court, on the date of the act of insolvency. It is enough if his ordinary residence has been in that area within a year from the date of the adjudication, i.e., it need not be even for one full year prior to the adjudication.

### Conditions on which creditor may petition

"(1) A creditor shall not be entitled to present an insolvency petition against a debtor unless—

(a) the debt owing by the debtor to the creditor, or if two or more creditors join in the petition, the aggregate amount of debts owing to such creditors, amounts to five hundred rupees, and

(b) the debt is a liquidated sum payable either immediately or at some certain future time, and

(c) the act of insolvency on which the petition is grounded has occurred within three months before the presentation of the petition.

(2) If the petitioning creditor is a secured creditor, he shall in his petition either state that he is willing to relinquish his security for the benefit of the creditors in the event of the debtor being adjudged insolvent, or give an estimate of the value of the security. In the latter case, he may be admitted as a petitioning creditor to the extent of the balance of the debt due to him after deducting the value so estimated in the same way as if he were an unsecured creditor." (Sec. 9).

### Conditions on which debtor may petition

They are as follows :—

"(1) A debtor shall not be entitled to present an insolvency petition, unless he is unable to pay his debts, and—

(a) his debts amount to five hundred rupees ; or

(b) he is under arrest or imprisonment in execution of the decree of any Court for the payment of money ; or

(c) an order of attachment in execution of such a decree has been made, and is subsisting, against his property.

(2) A debtor in respect of whom an order of adjudication whether made under the Presidency-towns Insolvency Act, 1909 or under this Act has been annulled, owing to his failure to apply, or to prosecute an application for his discharge, shall not be entitled to present an insolvency petition without the leave of the Court by which the order of adjudication was annulled. Such Court shall not grant leave unless it is satisfied either that the debtor was prevented by any reasonable cause from presenting or prosecuting his application, as the case may be, or that the petition is founded on facts substantially different from those contained in the petition on which the order of adjudication was made." (Sec. 10).

### Form of Insolvency Petition

Every insolvency petition shall be in writing and shall be signed and verified in the manner prescribed by the Code of Civil Procedure 1908 for signing and verifying plaints. (Sec. 12).

*Contents of debtor's petition :—*

"(1) Every insolvency petition presented by a debtor shall contain the following particulars, namely :—

(a) a statement that the debtor is unable to pay his debts;

(b) the place where he ordinarily resides or carries on business or personally works for gain, or if he has been arrested or imprisoned, the place where he is in custody ;

(c) the Court (if any) by whose order he has been arrested or imprisoned, or by which an order has been made for the attachment of his property, together with particulars of the decree in respect of which any such order has been made ;

(d) the amount and particulars of all pecuniary claims against him, together with the names and residences of his creditors so far as they are known to, or can by the exercise of reasonable care and diligence be ascertained by him ;

(e) the amount and particulars of all his property, together with—

(i) a specification of the value of all such property not consisting of money ;

(ii) the place or places at which any such property is to be found ;

(iii) a declaration of his willingness to place at the disposal of the Court all such property save in so far as it includes such particulars (not being his books of account) as are exempted by the Code of Civil Procedure 1908, or by any other enactment for the time being in force from liability to attachment and sale in execution of a decree.

(f) a statement whether the debtor has on any previous occasion filed a petition to be adjudged an insolvent, and (where such a petition has been filed)—

(i) if such petition has been dismissed, the reasons for such dismissal, or

(ii) if the debtor has been adjudged an insolvent, concise particulars of the insolvency, including a statement whether any previous adjudication has been annulled and, if so, the grounds therefor.”

[Sec. 13 (1) ]

### ***Contents of creditor's petition :—***

“(2) Every insolvency petition presented by a creditor or creditors shall set forth the particulars regarding the debtor specified in clause (b) of subsection (1), and shall also specify—

(a) the act of insolvency committed by such debtor, together with the date of its commission ; and

(b) the amount and particulars of his or their pecuniary claim or claims against such debtor.” [Sec. 13 (2) ].

**Note :—**According to the Presidency-towns Insolvency Act a debtor's petition need not contain the particulars enumerated in clauses (d) and (e) referred to in Sec. 13 (1) of the Provincial Insolvency Act. Further according to the former Act the lists of creditors and debtors may be filed even after the petition is admitted. According to the Provincial Insolvency Act both creditor's as well as debtor's petitions must be verified, but according

to the Presidency-towns Insolvency Act it is only the creditor's petition that should be verified.

*Withdrawal and Consolidation of Petitions etc :—*

• A petition whether presented by a debtor, or by a creditor shall not be withdrawn without the leave of the Court. (Sec. 14). Where two or more insolvency petitions are presented against the same debtor, or where separate petitions are presented against joint debtors, the Court may consolidate the proceedings of any of them on such terms as the Court thinks fit (Sec. 15). Where the petitioner does not proceed with due diligence on his petition, the Court may substitute as petitioner any other creditor to whom the debtor may be indebted in the amount required by this Act in the case of a petitioning creditor. (Sec. 16). If a debtor by or against whom an insolvency petition has been presented dies, the proceedings in the matter shall, unless the Court otherwise orders, be continued so far as may be necessary for the realisation and distribution of the property of the debtor. (Sec. 17). The procedure laid down in the Code of Civil Procedure, 1908, with respect to the admission of plaints, shall, so far as it is applicable, be followed in the case of insolvency petitions. (Sec. 18).

*Procedure on admission of Petition :—*

(1) Where an insolvency petition is admitted, the Court shall make an order fixing a date for hearing the petition.

(2) Notice of the order under sub-section (1) shall be given to creditors in such manner as may be prescribed.

(3) Where the debtor is not the petitioner, notice of the order under sub section (1) shall be served on him in the manner provided for the service of summons. (Sec. 19).

*Note :—* According to the P. T. I. Act there is no intermediate stage for the admission of the petition, between the filing of the petition and the order of adjudication, as is found in the P. I. Act. Further according to the P. T. I. Act on the filing of a petition, whether it be by a creditor or a debtor, the Court may adjudicate the debtor an insolvent if the statutory conditions are all satisfied.

**Receiving Order**

In England unless a petition for bankruptcy is dismissed or stayed, a '*receiving order*' will be made. The effect of that order is

to constitute the Official Receiver the receiver of all the debtor's property, and no action can thereafter be commenced against the debtor without the leave of the Court. The Official Receiver, if the circumstances so require, will be appointed a special manager of the debtor's business. The 'receiving order' is not necessarily final and may be rescinded subsequently. If it is not rescinded and no scheme or composition is submitted and approved by the Court, it will adjudicate the debtor a bankrupt. The property of the bankrupt then vests in a trustee and becomes divisible amongst his creditors.

### Proceedings from Admission of Petition to Adjudication

*Appointment of interim Receiver* :—The Court when making an order admitting the petition may, and where the debtor is the petitioner ordinarily shall, appoint an interim receiver of the property of the debtor or any part thereof, and the interim receiver shall thereupon have such of the powers conferrable on a receiver appointed under the Code of Civil Procedure, 1908, as the Court may direct. If an interim receiver is not so appointed the Court may make such appointment at any subsequent time before adjudication, and the provisions of this sub-section shall apply accordingly. (Sec. 20).

This section is intended to protect the debtor's estate for the benefit of the entire body of creditors. It may be noted that under the P. I. Act the Court is bound to appoint an interim receiver on the admission of a debtor's petition, but it may or may not appoint an interim receiver when the petition is by a creditor, but there is no such distinction made under the P. T. I Act, and in either case it is in the discretion of the Court. An interim receiver so appointed is an officer of the Court, and generally the Official Receiver will be appointed as the interim receiver. There is one point which may be noted, *viz.*, that on the appointment of an interim receiver the property of the debtor *does not vest* in him, so as take away the jurisdiction of Courts to proceed against the debtor's property, in execution of a decree obtained against him by individual creditors. But after adjudication, the property of the debtor *vests* in the Official Receiver and no proceedings can be taken against the property of the insolvent except with the leave of the Court. Even where an interim receiver has been appointed if a Court execut-

ing the decree against the insolvent's property is apprised of the admission of the insolvency petition before the property is sold, it shall direct the property, if in the possession of the Court, to be delivered to the receiver, but the costs of the suit in which the decree was made, and the execution shall be a first charge on the property so delivered, and the receiver may sell the property or a portion thereof for the purpose of satisfying the charge (Sec. 52). The powers and duties of an interim receiver are governed by Order XL Civil Procedure Code. In the Presidency-towns it is the Official Assignee that will be appointed as an interim receiver of the property of the debtor at any time after the presentation of the petition, and before the order of adjudication.

#### Interim proceedings against debtor and release of debtor

At or after the making of an order admitting the petition, the Court may either of its own motion or on the application of a creditor make one or more of the following orders : (i) order the debtor to furnish reasonable security for his appearance until final orders are made on the petition, and that in default he shall be detained in a civil prison ; (ii) order the attachment by actual seizure the whole or any part of the debtor's property which is in his possession or control, except those exempted by Civil Procedure Code ; (iii) order a warrant to issue with or without bail, for the arrest of the debtor and detention in the Civil prison until the disposal of the petition, or that he be released on such terms as to security as may be reasonable. But the Court shall not order the attachment or arrest of the debtor under cl. (2) and (3) above, unless it is satisfied that with intent to defeat or delay the creditors or avoid the process of the Court, the debtor has : (i) absconded or departed or about to abscond or depart from the local limits of the jurisdiction of the Court, or is remaining outside them, or (ii) or has failed to disclose or has concealed, destroyed, transferred or removed from such limits any documents likely to be of use to the creditors in the hearing of the petition, or any part of his property, or about to do any of the said acts. (Sec. 21). At or after the making of an order admitting the petition or after adjudication the Court may direct the release of the debtor, where he is under arrest, on such terms as to security as



may be reasonable. The Court may also direct the debtor so released to be re-arrested and re-committed to custody (Sec. 23).

### Duties of Debtors

The debtor shall, on making the order admitting the petition, do the following :—(i) produce all books of account, (ii) at any time thereafter give such inventories of his property and lists of his creditors and debtors and of debts due to and from them respectively, (iii) submit to such examination in respect of his property of his creditors, (iv) attend at such times before the Court or the Receiver as required, (v) execute the instruments as required, and (vi) generally do all such acts and things in relation to his property—as may be required by the Court or Receiver, or as may be prescribed. (Sec. 22).

#### *Procedure at hearing of the petition :—*

“(1) On the day fixed for the hearing of the petition, or on any subsequent day to which the hearing may be adjourned, the Court shall require proof of the following matters, namely :—(a) that the creditor or the debtor, as the case may be, is entitled to present the petition; Provided that where the debtor is the petitioner, he shall, for the purpose of proving his inability to pay his debts, be required to furnish only such proof as to satisfy the Court that there are *prima facie* grounds for believing the same and the Court, if and when so satisfied, shall not be bound to hear any further evidence thereon;

(b) that the debtor, if he does not appear on a petition presented by a creditor, has been served with notice of the order admitting the petition; and

(c) that the debtor has committed the act of insolvency alleged against him.

(2) The Court shall also examine the debtor, if he is present, as to his conduct, dealings and property in the presence of such creditors as appear at the hearing, and the creditors shall have the right to question the debtor thereon.

(3) The Court shall, if sufficient cause is shown, grant time to the debtor or to any creditor to produce any evidence which appears to it to be necessary for the proper disposal of the petition.

(4) A memorandum of the substance of the examination of the debtor and of any other oral evidence given shall be made by the Judge, and shall form part of the record of the case.” (Sec. 24).

**Note :—**In the Presidency-towns the debtor is not examined at the hearing of the petition or passing the order of adjudication. It takes place only after the adjudication order is made.

#### *Dismissal of Petition :—*

“(1) In the case of a petition presented by a creditor, where the Court is not satisfied with the proof of his right to present the petition, or of the

service on the debtor of notice of the order admitting the petition, or of the alleged act of insolvency, or is satisfied by the debtor that he is able to pay his debts, or that for any other sufficient cause no order ought to be made, the Court shall dismiss the petition.

• (2) In the case of a petition presented by a debtor, the Court shall dismiss the petition if it is not satisfied of his right to present the petition " (Sec. 25).

*Note :—*Where a creditor's petition is dismissed under Sub-Sec. (1) of Sec. 25 above, and the Court is satisfied that it was frivolous or vexatious, the Court may, on the application of the debtor, award against the creditor a sum not exceeding Rs. 1,000 towards compensation to the debtor for the expense or injury occasioned to him by the petition and the proceedings thereon. This award shall not bar a suit for compensation by the debtor in respect of the injury suffered by him on account of the petition and the proceedings thereon (Sec. 26). It may be noted that the Court can award compensation even some time after the dismissal of petition.

## ORDER OF ADJUDICATION

Sec. 27 lays down :—

(1) If the Court does not dismiss the petition, it shall make an order of adjudication and shall specify in such order the period within which the debtor shall apply for his discharge.

(2) The Court may, if sufficient cause is shown, extend the period within which the debtor shall apply for his discharge, and in that case shall publish notice of the order in such manner as it thinks fit." (Sec. 27).

*Note :—*According to the P. I. Act the Court is bound to make an order of adjudication when it does not dismiss the petition (whether it be by the debtor or creditor), except in cases where the passing of such an order would amount to an abuse of the process of the Court. According to the P.T.I. Act the Court *may* make an order of adjudication, even if all the conditions enumerated in the Act are complied with, and the Court has therefore greater discretion in the matter of passing an order of adjudication. Another duty imposed on the Court under the Provincial Insolvency Act is to specify the period within which the debtor should apply for his discharge, though the said period can be extended,

### Effect of an order of adjudication

“(1) On the making of an order of adjudication, the insolvent shall aid to the utmost of his power in the realisation of this property and the distribution of the proceeds among his creditors.

(2) On the making of an order of adjudication, the whole of the property of the insolvent shall vest in the Court or in a receiver as hereinafter provided and shall become divisible among the creditors, and thereafter, except as provided by this Act, no creditor to whom the insolvent is indebted in respect of any debt, provable under this Act shall during the pendency of the insolvency proceedings have any remedy against the property of the insolvent in respect of the debt or commence any suit or other legal proceeding except with the leave of the Court and on such terms as the Court may impose.

(3) For the purposes of Sub-section (2), all goods being at the date of the presentation of the petition on which the order is made, in the possession, order or disposition of the insolvent in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof, shall be the property of the insolvent.

(4) All property which is acquired by or devolves on the insolvent after the date of an order of adjudication and before his discharge shall forthwith vest in the Court or receiver, and the provisions of sub-section (2) shall apply in respect thereof.

(5) The property of the insolvent for the purpose of this section shall not include any property (not being books of account) which is exempted by the Code of Civil Procedure, 1908, or by any other enactment for the time being in force from liability to attachment and sale in execution of a decree.

(6) Nothing in this section shall affect the power of any secured creditor to realise or otherwise deal with his security, in the same manner as he would have been entitled to realise or deal with it, if this section had not been passed.

(7) An order of adjudication shall relate back to, and take effect from, the presentation of the petition on which it is made.” (Sec. 28).

According to Sec. 30 of the P. I. Act the said order of adjudication stating the name, address, description of the insolvent, the date of the adjudication, and the time granted for discharge, should be published in the Local Official Gazette. The corresponding Section of the P. T. I. Act is Sec. 20 and it lays down a similar rule. But Sec. 116(2) of the P. T. I. Act enacts that a copy of the Official Gazette containing notice of the order of adjudication shall be conclusive evidence of the order having been duly made, and its date.

Under sub-section (2) above it has been held that immovable property belonging to an insolvent, which will be governed by the law of the place where it is situate, would vest in the

Official Receiver only if it is situate in British India and not outside. Where it is situate within the jurisdiction of foreign Courts, the Official Receiver, or Official Assignee, as the case may be, has only to compel the insolvent to execute a transfer of the property in his favour, so as to effectively get title to and possession of the same, and thus enable him to realise the property through the foreign Court. Moveable property of the insolvent situate outside British India vests in the Official Receiver, under the above section, because moveable property, wherever situate, is governed by the law of the country where the insolvent is domiciled (namely British India). Sub-section (2) above also makes it clear that all property that vests in the Official Receiver shall be divisible among the creditors, and shall not thereafter be proceeded against by means of proceedings in any Court except with the leave of the Court, which shall be granted only subject to such terms as the Court thinks reasonable. It may be noted that the leave of the Court referred to above is a condition precedent to the commencement of all Civil proceedings, and it cannot therefore be obtained after the proceedings are started. Leave of the Court however is not necessary in respect of a criminal prosecution, nor for continuing legal proceedings already pending on the date of the adjudication, nor for proceedings by a secured creditor to realise his security.

### Reputed Ownership

Sub-Section (3) of Sec. 28 enacts what is known as the doctrine of 'reputed ownership' in respect of goods in the possession or disposition of the insolvent. In order that it might apply the conditions which should be satisfied are: (i) the goods must be in the possession, order, or disposition of the insolvent at the time of the presentation of the petition, (ii) the property must be goods—in the trade, or business of the insolvent, and (iii) they must be in the insolvent's possession with the consent of the true owner. If these conditions are satisfied, then according to the doctrine of reputed ownership, such goods would become vested in the Official Receiver and become divisible among the creditors, though in fact the insolvent is not the owner of the same, or has only a qualified interest in it. It should be noted that the doctrine of reputed ownership would not affect the rights of a secured creditor e.g., a person having a mortgage in respect of the goods. Whether reputed ownership exists or not is a

question of fact depending on the circumstances of each case. The important points of difference between the Provincial and Presidency-towns Insolvency Law on this question are : (i) according to the P. T. I. Act things in action, other than debts due to the insolvent, are not to be deemed goods for the purpose of this rule, and the true owner of any goods which have become divisible among the insolvent's creditors may prove for the value of such goods [Sec. 52 (2) Provisos 1 and 2]. But similar rules are not to be found in Sec. 28 (3) of the P. I. Act ; (ii) According to the P. I. Act the goods which may be in the insolvent's possession at the time of the *presentation of the petition* are affected by the rule, while according to the P. T. I. Act the goods in the insolvent's possession etc., at the time of the *act of insolvency* would be affected; (iii) The P. I. Act makes it clear that the rights of the secured creditor are not affected by this doctrine, while the P. T. I. Act contains no such rule.

*After acquired property* :—Under Sec. 28 (4) all property acquired or devolving on the insolvent after adjudication and before discharge vests in the Court or the Receiver, and it is made liable for division amongst creditors. It has been held in England in *Cohen v. Mitchell*, (1890) 25 Q. B. D. 262 to 267 that “until the trustee intervenes, all transactions by a bankrupt after his bankruptcy, with any person dealing with him *bona fide* and for value, in respect of his after acquired property, whether with or without the knowledge of the bankruptcy, are valid as against the trustee.” But this rule does not apply in the moffussil in view of the clear language of Sec. 28 (4). The Madras High Court has held that the rule in *Cohen v. Mitchell*, does not apply even in the case of after acquired immovable property of an insolvent, governed by the Presidency-towns Insolvency Act.

*Vesting of property when the manager of Hindu Joint family is adjudicated insolvent* :—

According to Sec. 52 (2) (b) of the P. T. I. Act “the capacity to exercise and take proceedings for exercising all such powers in or over, or in respect, of, property as might have been exercised by the insolvent for his own benefit, at the commencement of the insolvency or before his discharge” is also mentioned as the property of insolvent which is divisible among his creditors. It has, therefore, been held by the Privy Council in *Seth Narayan v.*

*Sri Kishendas* I. L. R. 17 Lah. 644 (P. C.), that the power of an insolvent father to alienate the joint family property, including the interest of his minor sons, for the payment of his antecedent debts, which are neither illegal nor immoral, vests in the Official Assignee, by virtue of Sec. 52 (2) (b) of the P. T. I. Act. It has been however held by a Full Bench of the Madras High Court in *Ramasastrulu v. Balakrishnarao*, I. L. R. (1943) Mad. 83 (F. B.), that under the P. I. Act on the adjudication of the manager of a joint Hindu family as insolvent, his power to sell the family assets to discharge the debts payable out of the joint estate, does not vest in the Official Receiver on the ground that such a power cannot be regarded as property under Secs. 2 (d) and 28 of the P. I. Act, and that the language in Sec. 52 of the P. T. I. Act which expressly vests such a right in the Official Assignee, has no counterpart in the P. I. Act. It was accordingly held that it was only the interest of the insolvent manager in the family properties that would vest in the Official Receiver. Following this Full Bench decision it was subsequently held by a bench of the same High Court in *Virupakshareddi v. Chennala Sivareddi*, 1943 (2) M. L. J. 87, that even the power of a father to sell his sons' shares would not vest in the Official Receiver on the adjudication of the father as an insolvent, under the provisions of the P. I. Act.

#### Doctrine of relation back

The rule laid down in Sec. 28 (7) is known as the doctrine of 'relation back'. The effect of that doctrine is that even though an insolvent's property actually becomes vested in the Official Receiver or Official Assignee, as the case may be, only after adjudication, still it will relate back to the date of the act of insolvency under the P. T. I. Act, and to the date of the presentation of the petition under the P. I. Act, so that all transactions entered into by the debtor subsequent to those dates, will not be binding on the Official Assignee and Official Receiver respectively. The practical consequence of this rule is that any payment to the insolvent by the creditor, or any payment by the insolvent to a creditor, any transfer by an insolvent in favour of a third party for consideration, or any contract or dealing by or with the insolvent for valuable consideration, would not bind the Official Receiver, unless they are protected transactions within the meaning of Sec. 55 P. I. Act. *viz.*, transactions which have taken place

before the date of the order of adjudication and in which the person dealing with the insolvent had no notice of the presentation of the insolvency petition by or against the debtor.

### Effect of order of adjudication on third parties

It has been held by the Privy Council in *Mahamad Sidik Yousuff v. Official Assignee, Calcutta*, I. L. R. (1943) 2 Cal. 517 (P.C.) that where by the order of adjudication on a creditor's petition under the P.T.I. Act, a transfer has been found to be an act of insolvency and as one made with intent to prefer the creditor (transferee), the said order of adjudication after being duly published in the Gazette is conclusive, and the transferee's title is conclusively avoided by the adjudication order, and cannot be disputed by him, though the said order was passed without notice to him. The remedy of the transferee in such cases was held to be to appeal as a "*person aggrieved*" against the adjudication order, which has so far determined his rights. A Full Bench of the Madras High Court in *The Official Receiver, Guntur v. Gopalakrishnayya and others*, (1945) 1 M. L. J. 17 held that the said decision has no application to cases arising under the P. I. Act.

*Stay of pending proceedings*.:—Any Court in which a suit or other proceeding is pending against a debtor shall, on proof that an order of adjudication has been made against him under this Act, either stay the proceeding or allow it to continue on such terms as such Court may impose. (Sec. 29).

### Proceedings consequent on order of adjudication

#### *Protection Order.*

"(1) Any insolvent in respect of whom an order of adjudication has been made may apply to the Court for protection, and the Court may on such application make an order for the protection of the insolvent from arrest or detention.

(2) A protection order may apply either to all the debts of the debtor, or to any of them as the Court may think proper, and may commence and take effect at and for such time as the Court may direct, and may be revoked or renewed as the Court may think fit.

(3) A protection order shall protect the insolvent from being arrested or detained in prison for any debt to which such order applies, and any insolvent arrested or detained contrary to the terms of such an order shall be entitled to his release :

Provided that no such order shall operate to prejudice the right of any creditor in the event of such order being revoked or the adjudication annulled.

(4) Any creditor shall be entitled to appear and oppose the grant of a protection order." (Sec. 31).

*Note :—*This section is intended to protect *bona fide* debtors from being persecuted by decree-holders, and to prevent undue advantage being derived by some of the creditors as against others. This protection does not, however, apply to an arrest of the insolvent in execution of the process of the Criminal Court.

*Power of arrest after adjudication :—*Under Sec. 32 the Court may at any time after the order of adjudication has been made, issue a warrant for the arrest of the debtor if he has absconded or departed from the local limits of its jurisdiction with intent to avoid any of his obligations under this Act, and when produced before it may release him only on furnishing such security as it considers reasonable, if it is satisfied that the insolvent was absconding with the intent as stated above. If such security is not furnished, the insolvent may be detained in the civil prison for a period not exceeding *three months*.

It may be noted that in the Presidency towns a similar power can be exercised even where the debtor is only *about* to abscond or *about* to remove his property, or has removed property of the value of about Rs. 50 without the permission of the Official Assignee. Further there is no limit of three months fixed for detention of such debtor.

*Insolvent to aid the Official Receiver :—*

We have already noticed the duties of an insolvent after the petition is admitted. On the making of an order of adjudication the insolvent shall aid to the utmost of his power in the realisation of his property, and the distribution of the proceeds amongst his creditors. [Sec. 28 (1)]. The Presidency Towns Insolvency Act Sec. 33 (1) enumerates the duties of an insolvent in respect of the realization and discovery of the property as follows :

(i) attend any meeting of the creditors when required, and submit himself to such examination and give such information as required by the Official Assignee;

(ii) give an inventory of his property and lists of his creditors and debtors, and of debts due to and from them respectively;



(iii) submit to such examination in respect of his property or his creditors ;

(iv) attend before the Official Assignee or special manager where and when required ;

(v) execute powers of attorney, transfers and instruments, and

(vi) do all such acts and things in relation to his property and the distribution of the proceeds amongst his creditors, as may be required by the Official Assignee or special manager or by the Court.

It is also enacted that an omission on his part to do any of the aforesaid acts shall, in addition to any other punishment amount to a contempt of Court for which he shall be punished. (P.T.I. Sec. 28).

Sec. 59-A P. I. Act lays down that where an insolvent commits default in the matter of appearance, or production of property, or giving information, he may be arrested under a warrant and brought up for such examination. It may be noted that a similar power may be exercised in respect of any person known or suspected to have in his possession any property belonging to the insolvent, or supposed to be indebted to the insolvent, or any person who in the opinion of the Court is capable of giving information in respect of the insolvent or his dealings. These provisions are intended to enable the Court, as well as the Official Receiver or Assignee, as the case may be, to obtain information from the insolvent and third parties or both. With a view to prevent such persons from being compelled to make admissions or incriminating confessions, it has been enacted that they could be represented by a legal practitioner at those examinations.

## ANNULMENT OF ADJUDICATION

### *Power to annul adjudication.*

Sec. 35 lays down :—

“ Where in the opinion of the Court, a debtor ought not to have been adjudged insolvent, or where it is proved to the satisfaction of the Court that the debts of the insolvent have been paid in full, the Court shall, on the application of the debtor, or of any other person interested, by order in writing, annul the adjudication. And the Court may, of its own motion or on

application made by the receiver or any creditor, annul any adjudication made on the petition of a debtor who was, by reason of the provision of subsection (2) of section 10 not entitled to present such petition." (Sec. 35.)

This section specifically enumerates that : (i) where the debtor ought not to have been adjudged insolvent, or (ii) where the debts of the insolvent have been paid in full, or (iii) where the adjudication was made on a second petition filed by the insolvent without leave of the Court, as required by Sec. 10 (2) P. I. Act, the adjudication already made can be annulled. In addition to these three cases adjudication may also be annulled : (iv) when the insolvency proceedings are pending in another Court against the same debtor, and it has been proved that the property of the debtor can be more conveniently distributed by that other Court ; (Sec. 36) or (v) where the insolvent submits a scheme for composition and the same has been approved by the Court ; (Sec. 39). or (vi) where the debtor does not appear at the hearing of his application for discharge, or does not apply for discharge within the time specified by the Court (Sec. 43).

The fact that the debtor has not objected to the order of adjudication being passed against him, does not prevent the Court from setting it aside under Sec. 35 P. I. Act. When it is proved that no act of insolvency has been committed, the Court under the P. I. Act has no discretion, and must annul the order of adjudication, while the Court under the P. T. I. Act has a discretion, *Periakaruppan Chettiar v. Arunachalam Chettiar* (1940) 1 M. L. J. 228 (F.B.).

*Proceedings on annulment :—*

"(1) Where an adjudication is annulled, all sales and dispositions of property and payments duly made, and all acts theretofore done, by the Court or receiver shall be valid, but, subject as aforesaid, the property of the debtor who was adjudged insolvent shall vest in such person as the Court may appoint, or, in default of any such appointment shall revert to the debtor to the extent of his right or interest therein on such conditions (if any) as the Court may, by order in writing declare. (2) Notice of every order annulling an adjudication shall be published in the local official Gazette and in such other manner as may be prescribed." (Sec. 37).

*Note :—*Where an order of adjudication is annulled the debtor if released from custody may be re-committed to custody,

and thereupon all processes which were in force against the person of such debtor at the time of such release as aforesaid, shall be deemed to be still in force against him, as if no order of adjudication has been made.

### **Composition and schemes of arrangement**

A composition is an arrangement by which a debtor obtains release of his debts from all, or some of his creditors, by their accepting an amount less than what is due to them in full satisfaction of their claims. This may take place independently of any proceedings under the Insolvency Acts or under the Acts. Where it is not done under the Act it is generally evidenced by a document called a composition deed which provides for a transfer by the insolvent of all his properties in favour of one or more trustees, who shall be charged with the duty of distribution of the proceeds realised from the insolvent's property amongst his creditors. It may be noted that the execution of a composition deed is according to Sec. 6 (a) an act of insolvency, on the strength of which an insolvency petition can be filed.

The Insolvency Act deals with the scheme of composition arrived at only after the order of adjudication is made. In England though a composition may take place either before or after adjudication in bankruptcy, as a rule it precedes adjudication and is consented to at a specially called meeting by the Official Receiver soon after the receiving order is made. It has already been noted that in India there is no provision made for a receiving order in the first instance, and a subsequent order of adjudication and therefore according to both the P. T. I. Act as well as the P. I. Act a scheme of composition can be submitted only after the adjudication order, and the rule is as follows :

“(1) Where a debtor, after the making of order of adjudication, submits a proposal for a composition in satisfaction of his debtors, or a proposal for a scheme of arrangement of his affairs, the Court shall fix a date for the consideration of the proposal, and shall issue a notice to all creditors in such manner as may be prescribed.

(2) If, on the consideration of the proposal a majority in number and three fourths in value of all the creditors whose debts are proved and who are present in person or by pleader, resolve to accept the proposal, the same shall be deemed to be duly accepted by the creditors.

(3) The debtor may at the meeting amend the terms of his proposal if the amendment is, in the opinion of the Court, calculated to benefit the general body of creditors.

(4) Where the Court is of opinion, after hearing the report of the receiver, if a receiver has been appointed, and after considering any objections which may be made by or on behalf of any creditor, that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors the Court shall refuse to approve the proposal.

(5) If any facts are proved on proof of which the Court would be required either to refuse, suspend or attach conditions to the debtor's discharge, the Court shall refuse to approve the proposal unless it provides reasonable security for payment of not less than six annas in the rupee on all the unsecured debts provable against the debtor's estate.

(6) No composition or scheme shall be proved by the Court which does not provide for the payment in priority to other debts of all debts directed to to be so paid in the distribution of the property of an insolvent.

(7) In any other case the Court may either approve or refuse to approve the proposal." (Sec. 38).

*Note* :—A composition or scheme is permitted primarily in the interests of creditors, with a view to save trouble and time, which proceedings in insolvency would necessarily entail. The approval of the Court for the same is insisted upon with the object of (i) preventing a majority of creditors from dealing recklessly not only with their property but with that of the creditors in the minority ; and (ii) of enforcing a more careful and moral conduct on the part of the debtors—in other words to improve the standard of commercial morality.

### Effect of an order accepting Composition or Scheme

Section 39 lays down ;

"If the Court approves the proposal, the terms shall be embodied in an order of the Court and the order of adjudication shall be annulled, and the provisions of Sec. 37 shall apply, and the composition or scheme shall be binding on all the creditors so far as relates to any debt due to them from the debtor and provable under this Act." (Sec. 39).

*Power to annul Composition or Scheme, and the effect of such annulment* :—

In the following cases the order of composition or scheme may be annulled :

(i) if default is made in the payment of any instalment due thereunder ; or

(ii) if it appears to the Court that the composition or scheme cannot proceed without injustice or undue delay ; or

(iii) if the approval of the Court was obtained by fraud.

If the Court annuls the composition it readjudges the debtor, insolvent, but without prejudice to the validity of any transfer or payment duly made or of anything duly done under or in pursuance of the composition or scheme. When a debtor is re-adjudged an insolvent all debts provable in other respects which have been contracted before the date of such re-adjudication shall be provable in insolvency.

### Discharge of Insolvent

Sec. 41 enacts :

1. "A debtor may, at any time after the order of adjudication and shall, within the period specified by the Court, apply to the Court for an order of discharge, and the Court shall fix a day, notice whereof shall be given in such manner as may be prescribed for hearing such application and any objections which may be made thereto.

2. Subject to the provisions of this section the Court may, after considering the objections of any creditor and, where a receiver has been appointed, the report of the receiver :

(a) grant or refuse an absolute order of discharge; or

(b) suspend the operation of the order for a specified time ; or

(c) grant an order of discharge subject to any conditions with respect to any earnings or income which may afterwards become due to the insolvent, or with respect to his after-acquired property." (Sec. 41).

**Cases in which Court must refuse absolute discharge.**

Sec. 42 lays down :

"The Court shall refuse to grant an absolute order of discharge under section 41 on proof of any of the following facts, namely :—

(a) that the insolvent's assets are not of a value equal to eight annas in the rupee on the amount of his unsecured liabilities, unless he satisfies the Court that the fact that the assets, are not of a value equal to eight annas in the rupee on the amount of his unsecured liabilities has arisen from circumstances for which he cannot justly be held responsible ;

(b) that the insolvent has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately preceding his insolvency;

(c) that the insolvent has continued to trade after knowing himself to be insolvent;

(d) that the insolvent has contracted any debt provable under this Act without having at the time of contracting it any reasonable or provable ground of expectation (the burden of proving which shall lie on him) that he would be able to pay it;

(e) that the insolvent has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet his liabilities;

(f) that the insolvent has brought on, or contributed to his insolvency by rash and hazardous speculations or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs ;

(g) that the insolvent has, within three months preceding the date of the presentation of the petition, when unable to pay his debts as they became due, given an undue preference to any of his creditors ;

(h) that the insolvent has on any previous occasion been adjudged an insolvent or made a composition or arrangement with his creditors ;

(i) that the insolvent has concealed or removed his property or any part thereof, or has been guilty of any other fraud or fraudulent breach of trust.

(2) For the purpose of this section the report of the receiver shall be deemed to be evidence, and the Court may presume the correctness of any statement contained therein.

(3) The powers suspending, and of attaching conditions to, an insolvent's discharge may be exercised concurrently." (Sec. 42).

*Note :—*According to the P. T. I. Act, the Court may refuse discharge or suspend it for a specified time, or suspend it until a dividend of not less than four annas in the rupee has been paid, or impose conditions which will be attached to the order of discharge not only in the cases enumerated in Sec. 42 of P. I. Act, but also in the following cases :—

(i) where he has put any of his creditors to unnecessary expense by *frivolous or vexatious* defence to any suit properly brought against him.

(ii) where within three months preceding the time of presentation of the petition the insolvent has brought a *frivolous or vexatious* suit.

It may also be noted that under the P. I. Act the Court shall refuse an order of absolute discharge if the insolvent's assets are not of the value equal to *eight annas* in the rupee on the amount of his unsecured liability, unless he offers satisfactory explanation for the same. According to Section 39, P. T. I. Act the Court shall likewise refuse absolute discharge if the insolvent's

assets are less than *four annas* in the rupee on the amount of his unsecured liabilities, unless he satisfies the Court that the assets are not of such value on account of circumstances beyond his control.

### Effect of Order of Discharge

Sec. 44 lays down :

"1. An order of discharge shall not release the insolvent from :—

- (a) any debt due to the Crown ;
- (b) any debt or liability incurred by means of any fraud or fraudulent breach of trust to which he was a party ; or
- (c) any debt or liability in respect of which he has obtained forbearance by any fraud to which he was a party ; or
- (d) any liability under an order for maintenance made under section 488 of the Code of Criminal procedure, 1898.

2. Save as otherwise provided by sub-section (1) an order of discharge shall release the insolvent from all debts provable under this Act.

3. An order of discharge shall not release any person who, at the date of the presentation of the petition, was a partner or co-trustee with the insolvent, or was jointly bound or had made any joint contract with him or any person who was surety for him." (Sec. 44).

It may be noted that an order of discharge obtained by a principal debtor does not discharge the surety ; and the only remedy of the surety in a case where the principal debtor is adjudicated an insolvent is to prove along with other creditors of the insolvent for the debt which he may have to pay.

### Administration of Property

*Debts provable under the Act* :—All debts and liabilities present or future, certain or contingent, to which the debtor is subject when he is adjudged an insolvent, or to which he may become subject before his discharge by reason of any obligation incurred before the date of such adjudication, shall be deemed to be debts provable under this Act.

The following debts however are not provable under the Act ;

- (i) debts incapable of being fairly estimated ;
- (ii) demands in the nature of unliquidated damages arising otherwise than by reason of a contract or breach of trust (e.g., damages for tort). (Sec. 34 P. I. Act).

In addition to these two debts, according to Sec. 46 (1) of the P. T. I. Act debts or liabilities contracted by the insolvent from a person having notice of the presentation of an insolvency petition by or against a creditor, is also not provable.

The language used in the section is very wide and it enables all kinds of debts or liabilities of the insolvent to be proved, except those enumerated above. The following have been held to be debts provable in insolvency :

(i) On the insolvency of a surety the creditor can prove for the whole amount due, notwithstanding that he may have since that date received sums on account from the principal debtor, or co-surety, provided he (the creditor) does not receive more than 16 annas in the rupee ;

(ii) damages for breach of contract ;

(iii) damages for breach of trust ;

(iv) annuities for life.

It may be noted that it is only debts incurred prior to the adjudication order that are provable in insolvency and not those contracted thereafter. Even a debt contracted after the filing of the petition and before the date of the adjudication order cannot be proved in insolvency.

When a debt is provable under the Act, the consequences are two fold ; (i) the creditor will be precluded from taking proceedings in a Court of law for its recovery, and (ii) he has to be satisfied with the dividends paid out of the estate, and (iii) after the insolvent obtains a discharge the persons entitled to the provable debts are not entitled to any further remedy against the insolvent.

*Debt payable at a future time:—*

A creditor may prove for a debt not payable when the debtor is adjudged an insolvent, as if it were payable presently, and may receive a dividend equally with the other creditors, deducting therefrom only a rebate of interest at the rate of six per centum per annum, computed from the declaration of a dividend to the time when the debt would have become payable according to the terms on which it was contracted. (Sec. 45).



### Mode of proof of debts.

(1) A debt may be proved under this Act by delivering, or sending by post in a registered letter, to the Court an affidavit verifying the debt.

(2) The affidavit shall contain or refer to a statement of account showing the particulars of debts, and shall specify the vouchers (if any) by which the same can be substantiated. The Court may at any time call for the production of the vouchers. (Sec. 49).

### Mutual Dealings and Set-off

Where there have been mutual dealings between an insolvent and a creditor proving or claiming to prove a debt under this Act, an account shall be taken of what is due from the one party to the other in respect of such mutual dealings, and the sum due from the one party shall be set off against any sum due from the other party, and the balance of the account, and no more, shall be claimed or paid on either side respectively. (Sec. 46).

### Right of secured creditor to prove his debt

Sec. 47 lay down :

" (1) Where a secured creditor realises his security he may prove for the balance due to him after deducting the net amount realised.

(2) Where a secured creditor relinquishes his security for the general benefit of the creditors, he may prove for his whole debt.

(3) Where a secured creditor does not realise or relinquish his security, he shall, before being entitled to have his debts entered in the schedule state in the proof the particulars of his security, and the value at which he assesses it, and shall be entitled to receive a dividend only in respect of the balance due to him after deducting the value so assessed.

(4) Where a security is so valued, the Court may at any time before realisation redeem it on payment to the creditor of the assessed value.

(5) Where a creditor after having valued his security, subsequently realises it, the net amount realised shall be substituted for the amount of any valuation previously made by the creditor, and shall be treated in all respects as an amended valuation made by the creditor.

(6) Where a secured creditor does not comply with the provisions of this section, he shall be excluded from all share in any dividend." (Sec. 47).

### Interest on Provable Debts.

The Act provides that even where a rate of interest has been provided for, the creditor shall not be entitled for purposes of dividend to calculate interest at a rate exceeding 6 per cent per

annum, until all the debts that have been proved have been paid in full, when he will be entitled to claim a higher rate thereafter. Where interest has not been reserved and a debt provable under the Act is over due when the debtor is adjudged insolvent, the creditor may prove for interest at a rate not exceeding six per centum per annum : (i) if the debt is payable under a written instrument at a certain time, from that time till the date of adjudication, and (ii) where the debt is payable otherwise than under a written instrument from the date of demand in writing claiming interest till the date of adjudication. (Sec. 48).

#### Schedule of creditors

Sec. 33 enacts :—

“ 1. When an order of adjudication has been made under this Act, all persons alleging themselves to be creditors of the insolvent in respect of debts provable under this Act shall tender proof of their respective debts, by producing evidence of the amount and particulars thereof, and the Court shall, by order, determine the persons who have proved themselves to be creditors of the insolvent in respect of such debts, and the amount of such debts, respectively, and shall frame a schedule of such persons and debts :

Provided that, if in the opinion of the Court, the value of any debt is incapable of being fairly estimated, the Court may make an order to that effect, and thereupon the debt shall not be included in the schedule.

(2) A copy of every such schedule shall be posted in the Court house.

(3) Any creditor of the insolvent may at any time before the discharge of the insolvent tender proof of his debt and apply to the Court for an order directing his name to be entered in the schedule as a creditor in respect of any debt provable under this Act, and not entered in the schedule, and the Court, after causing notice to be served on the receiver and the other creditors who have proved their debts, and hearing their objection (if any), shall comply with or reject the application.” (Sec. 33).

#### Disallowance and reduction of entries in schedule

Sec. 50 lays down :—

“ 1. Where the receiver thinks that a debt has been improperly entered in the schedule the Court may, on the application

of the receiver and after notice to the creditor and such inquiry (if any) as the Court thinks necessary, expunge such entry or reduce the amount of the debt.

2. The Court may also, after like inquiry expunge an entry or reduce the amount of a debt upon the application of a creditor where no receiver has been appointed, or where the receiver declines to interfere in all matters, or in the case of a composition or scheme, upon the application of the debtor." (Sec. 50).

### Effect of insolvency on antecedent transactions

#### *Restriction of rights of creditors under execution :—*

"(1) Where execution of a decree has issued against the property of a debtor, no person shall be entitled to the benefit of the execution against the receiver except in respect of assets realised in the course of the execution by sale or otherwise before the date of the admission of the petition.

(2) Nothing in this section shall affect the rights of a secured creditor in respect of the property against which the decree is executed.

(3) A person who in good faith purchased the property of a debtor under a sale in execution shall in all cases acquire a good title to it against the receiver." (Sec. 51.)

*Note :—*The law in the Presidency-towns is the same except that the assets should have been realised in execution before the date of the order of adjudication and before the creditor had notice of the presentation of the petition by or against the debtor. (Sec. 53 (1) P. T. I. Act.).

### Duties of Court executing decree as to property taken in execution

Where execution of a decree has issued against any property of a debtor which is saleable in execution, and before the sale thereof notice is given to the Court executing the decree that an insolvency petition by or against the debtor has been admitted, the Court shall, on application, direct the property, if in the possession, of the Court, to be delivered to the receiver, but the costs of the suit in which the decree was made and of the execution shall be a first charge on the property so delivered, and the receiver may sell the property or an adequate part thereof for the purpose of satisfying the charge. (Sec. 52.)

### Avoidance of Voluntary Transfer

Sec. 53 lays down :

(1) Any transfer of property (2) not being a transfer made before and in consideration of marriage or made in favour of purchaser or incumbrancer in good faith and for valuable consideration shall, (3) if the transferor is adjudged insolvent on a petition presented within *two years* after the date of transfer, (4) be voidable as against the receiver and may be annulled by the Court. (Sec. 53.)

This section provides a remedy for avoiding voluntary transfers made by an insolvent to the prejudice of his creditors, without having to file a regular suit in the ordinary course. The fraudulent transfer can be avoided at the instance of the Official Receiver or the Official Assignee, as the case may be, but according to the P. I. Act the transfer in question must have been made within 2 years prior to the presentation of the petition on which the debtor has been adjudged insolvent. According to the P. T. I. Act the petition should have been filed within two years from the first act of insolvency proved to have been committed by the debtor within 3 months immediately preceding the presentation of the insolvency petition. The transfer is only voidable but not void, and when it is set aside by the Court the property reverts to the insolvent and vests in the Official Assignee or Official Receiver as the case may be, and becomes available for distribution amongst the creditors. The only two kinds of voluntary transfers which have been excepted from the operation of Section 53 are (i) transfers made before and in consideration of marriage; and (ii) transfers made in favour of a purchaser or incumbrancer in good faith and for valuable consideration.

It has been held by the Privy Council in *Official Receiver v. P. L. K. M. R. M. Chettiar* (1931) 58 I.A. 115 that the burden of proving absence of good faith on the part of the purchaser, and absence of valuable consideration, under Sec. 53 was on the Official Receiver. The application under this section may be filed at any time during the pendency of the insolvency proceedings. Where property has been transferred by a deed which falls within the mischief of Sec. 53 Transfer of Property Act, and the transferor becomes insolvent, the property does not form part of his estate within the purview of S. 17 P. T. I. Act or Sec. 28 P. I. Act, except when the Official Assignee or Official Receiver obtains a declaration that the transaction offends

against Sec. 53 T. P. Act. Accordingly in order to institute a suit under Sec. 53 T.P. Act the leave of the insolvency court is not necessary. If the creditor desires to make the Official Assignee or Official Receiver a party to such a suit the consent of the insolvency court is necessary. *Chidambaram Chettiar v. Sella Kumara Goundan and others* (1941) 2 M.L.J. 689 (F.B.)

### Avoidance of preference in certain cases

Sec. 54 enacts :—

“1. (i) Every transfer of property, every payment made, every obligation, incurred and every judicial proceedings taken or suffered; (ii) by any person unable to pay his debts as they become due from his own money, (iii) in favour of any creditor with a view of giving that creditor preference over the other creditors, shall, (iv) if such person is adjudged insolvent on a petition presented within *three months* after the date thereof, (v) be deemed fraudulent and void as against the receiver, and shall be annulled by the Court.

2. This section shall not affect the rights of any person who in good faith and for valuable consideration has acquired a title through or under a creditor of the insolvent.” (Sec. 54).

*Note* :—The various conditions that should be satisfied before this section can be applied have been noted in small *Roman numerals*. The section will not apply unless the transfer or payment etc., was made by the insolvent with the predominant, if not the sole, object of giving preference to a particular creditor. It therefore follows that if the transfer or payment was made under threat of legal proceedings, Section 54 may not have application. It has also been held that it is not the good faith of the creditor that is relevant, but the good faith of the insolvent in making that preference that has to be considered in each case. As in the cases governed by Sec. 53 it is the Official Receiver or Assignee that has to establish that the insolvent made the transfer or payment with fraudulent intent referred to in the section.

*By whom petitions for annulment of transfers may be made*:—

A petition for the annulment of any transfer under Section 53, or of any transfer, payment, obligation or judicial proceedings under Section 54, may be made by the receiver, or with the leave of the Court by any creditor, who has proved his debt, and who satisfies the Court that the receiver has been requested and has refused to make such petition. (Sec. 54-A).

### Protection of bona fide transactions

#### Sec. 55 enacts :

“ Subject to the foregoing provisions of this Act, with respect to the effect of insolvency on an execution, and with respect to the avoidance of certain transfers and preferences, nothing in this Act shall invalidate in the case of an insolvency—

- (a) any payment by the insolvent to any of his creditors;
- (b) any payment or delivery to the insolvent;
- (c) any transfer by the insolvent for valuable consideration; or
- (d) any contract or dealing by or with the insolvent for valuable consideration :

Provided that any such transaction takes place before the date of the order of adjudication, and that the person with whom such transaction takes place has not at the time notice of the presentation of any insolvency petition by or against the debtor.” (Sec. 55).

*Note* :—This section protects bona fide transactions of third persons entered into with the insolvent even after the presentation of the petition, provided they are prior to the date of the order of adjudication. In order that the section can be invoked the following conditions have to be satisfied :

(i) the payment or other transaction in question must be bona fide;

(ii) it should have taken place before the order of adjudication ;

(iii) the third party should have had no notice of the presentation of the insolvency petition by or against the debtor ; and

(iv) the transaction must not be one amounting to a voluntary transfer or fraudulent preference within the meaning of Secs. 53 and 54 of the Act.

### Property divisible among Creditors

We have already noticed that Sec. 2 (1) (d) P. I. Act defines property as including any property over which, or the profits of which any person has a disposing power, which he may exercise for his own benefit, Sec. 28 (5) enacts that the property of the insolvent for the purpose of this section shall not include any property (not being books of account) which is (1) exempted by the Code of Civil Procedure 1908, or (2) by any other enactment, for the time being in force, from liability to attachment and sale

in execution of a decree. It has also been noticed that the after-acquired property of the insolvent vests in the Official Receiver under the P. I. Act, and that the power of the manager or the father of a Joint Hindu Family to alienate the shares of other members of the family for debts contracted by him, which are binding on the family, does not, on his adjudication as insolvent, vest in the Official Receiver under the P. I. Act.

It has been held that the following properties also do not vest in the Official Receiver, nor become divisible for payment amongst the creditors :—(i) property delivered under a contract of bailment; (ii) trust property; (iii) tools of trade ; (iv) necessary wearing apparel and bedding of himself, his wife and children ; (v) pension; (vi) provident money, before it was paid to the subscriber (insolvent).

The following properties of the insolvent were held to vest in the Official Receiver :—

(i) moneys of the insolvent paid by him shortly prior to insolvency, which is void against the Official Receiver; (ii) personal earnings and salary of the insolvent upto the date of discharge, subject to the provision for maintenance of the insolvent and his children; (iii) secret formula of certain articles invented by the insolvent; (iv). life insurance policies; (v) goods of which he *is a reputed owner*, (see *supra*); (vi) good-will of the business carried on by the insolvent; (vii) where the insolvent is a partner in a firm and the firm is not dissolved on account of the insolvency, the assets of the insolvent partner in the firm on the date of adjudication; (viii) undivided share of the insolvent when he is a member of a Joint Hindu family; (ix) all actionable claims of the insolvent; (x) all claims for damages which accrued prior to the insolvency, except those for bodily injuries or personal suffering.

*Note:—*Except for the differences noted *supra*, regarding the vesting of after acquired property, and the power of a manager or father to alienate the shares of other members of the family, the law in the Presidency Towns and the mofussil regarding the properties which vest in the Official Receiver or Assignee, and become divisible amongst creditors is the same.

## REALISATION OF PROPERTY

### Official Assignee and Official Receiver

The main object of insolvency proceedings being the speedy realisation and distribution of the assets of the insolvent amongst the creditors the law has provided in England as well as in our country, for the appointment of an officer to discharge those functions. In England the officer who has to realise and distribute the property of the bankrupt is generally one of the creditors called 'Trustee in Bankruptcy', and the officer who has to investigate into the conduct of the debtor is called 'Official Receiver'. Both of them are officers of the Bankruptcy Court and are subject to the control of the Board of Trade (a department of the Government). In British India according to the P.T.I. Act the power to enquire into the conduct of the debtor, as well as the duty of realising and distributing the property are vested in the Official Assignee. According to P. I. Act, those powers outside the Presidency Towns are vested in the Official Receivers. The Official Assignee at Madras is appointed by the Chief Justice of the High Court, while the Official Assignees of Bengal and Bombay are appointed by the Provincial Governments. The Official Receivers are appointed in all Provinces by the respective Local Governments.

It may be noted that the procedure to be followed by the Official Assignee under the P. T. I. Act for realisation of the insolvent's estate far more elaborate and complex than that obtaining in the mofussil. The Official Assignee as well as the Official Receiver have two fold capacity as they represent the insolvent in the matter of realising the property, and the creditors in the matter of distributing the property.

*Appointment of Receiver:—*The Court may at the time of the order of adjudication or at any time afterwards appoint a receiver for the property of the insolvent, and such property shall thereupon vest in the receiver. The receiver so appointed may be required to furnish security for duly accounting for the insolvent's property which he receives, and may also be paid a remuneration for his services out of the insolvent's estate. After appointing a receiver the Court may remove any person in possession of the insolvent's property who could have been removed by the insolvent himself, and put the same in possession of the receiver.



Where the receiver fails to submit the accounts or the balance due from him, or occasions loss to the insolvent's property, the Court may make good such loss out of the property of the receiver. These provisions also apply to interim receivers (Sec. 56).

*Note:—*Under this section the Court can appoint a receiver to discharge the functions of an Official Receiver, where one such has not been appointed for that area by the Local Government.

*Power to appoint Official Receivers:—*

(1) The Local Government may appoint such person as it thinks fit (to be called 'Official Receivers') to be receivers under this Act within such local limits as it may prescribe.

(2) Where any Official Receiver has been so appointed for the local limits of the jurisdiction of any Court having jurisdiction under this Act, he shall be the receiver for the purpose of every order appointing a receiver or an interim receiver issued by any such Court, unless the Court for special reasons otherwise directs.

(3) Any sum payable under clause (b) of sub-section (2) of Section 56 in respect of the services of an official Receiver shall be credited to such fund as the Local Government may direct.

(4) Every Official Receiver shall receive such remuneration out of the said fund or otherwise as the Local Government may fix in this behalf, and no remuneration whatever beyond that so fixed shall be received by the Official Receiver as such." (Section 57.)

The Official Receiver who is appointed for the local area, can exercise the powers of a receiver under Section 59 (*infra*) even without an order of the Court. Section 57 makes it clear, that unless the Court otherwise directs, the Official Receiver shall be the receiver for the purpose of every order appointing a receiver, or an interim receiver by a Court. It may be noted that in addition to the powers enumerated in Sec. 59 which are of an administrative nature, the Court may under Section 80 delegate to the Official Receiver certain judicial functions. The Official Receiver is a public officer within the meaning of Sec. 2 (17) of Civil Procedure Code, and is therefore entitled to the statutory notice under Sec. 80 of that Code before he can be sued for any of his acts done in his official capacity.

*Powers of Court if no Receiver is appointed:—*

Where no receiver is appointed, as in the case of small insolvencies, the Court shall have all the rights, and may exercise all the powers conferred on a receiver under this Act. (Sec. 58).

### Duties and powers of Receiver

Subject to the provisions of this Act the receiver is bound to realise the property of the debtor and distribute the dividend amongst the creditors with all convenient speed, and for that purpose he may exercise the following powers : (i) sell all or any part of the insolvents' property, and (ii) give receipts for moneys received by him. The Official Receiver can exercise these two powers by virtue of his office. The following powers can also be exercised by him with the leave of the Court *viz* :—(iii) carry on the insolvent's business to the extent necessary for the beneficial winding up of the same ; (iv) institute, defend, or continue suits, and other legal proceedings in respect of the insolvents' property; (v) engage a pleader or other agent for that same purpose; (vi) accept as consideration for sale of the insolvent's property a sum of money payable at a future date subject to such stipulations as to security as the Court thinks fit; (vii) raise money for paying debts by mortgage or pledge of the insolvent's property; (viii) refer any dispute for arbitration, and compromise all debts, claims and liabilities on such terms as may be agreed upon; (ix) divide in its existing form amongst the creditors, according to its estimated value, any property which, from its peculiar nature or other special circumstances, cannot readily or advantageously be sold. (Sec. 59.)

### Delegation of powers to Official Receiver

We have already noticed above that the Court may delegate some of its judicial powers to an Official Receiver. With the sanction of the Local Government, the High Court may direct the Official Receiver to exercise, subject to the direction of the Court, any of the following powers namely (i) to frame schedules and to admit or reject proofs of creditors ; (ii) to make interim orders in any case of urgency; (iii) to hear and determine any unopposed or *ex parte* applications. Against any order passed or act done by the Official Receiver in exercise of these powers an appeal may be preferred to the Court under Sec. 68, within 21 days from the date of the act or the decision complained of.

### Distribution of Insolvents' Property

#### *Preferential Debts :*

(1) In the distribution of the property of the insolvent, there shall be paid in priority to all other debts :—

(a) all debts due to the Crown or to any local authority ;  
and

(b) all salary or wages, not exceeding twenty rupees in all, of any clerk, servant or labourer in respect of services rendered to the insolvent during *four months* before the date of the presentation of the petition. [Sec. 61 (1)].

*Note* :—The debts enumerated above are called *preferential debts*. According to P. T. I. Act : (i) the debts due to the crown, (ii) the salary of any clerk, not exceeding Rs. 300 to each clerk, and (iii) all wages not exceeding Rs. 100 for each servant, or labourer in respect of services rendered to the insolvent *during four months* before the date of the petition, and (iv) rent due to the landlord from the insolvent for not more than one month have been enumerated as preferential debts.

Further the amounts due in respect of any compensation payable under the Workmen's Compensation Act, the liability wherefor accrued before the date of the order of adjudication of the insolvent, should also be included among the preferential debts according to P. T. I. Act as well as the P. I. Act. (Sec. 14 (4) Workmen's Compensation Act-)

#### *Payment of preferential debts :*

Section 61 lays down :—

1. The debts specified in sub-sec. (1) (i.e. preferential debts) shall rank equally between themselves, and shall be paid in full, unless the property of the insolvent is insufficient to meet them, in which case they shall abate in equal proportions between themselves.

2. Subject to the retention of such sums as may be necessary for the expenses of administration or otherwise, the debts specified in sub-sec. (1) shall be discharged forthwith in so far as the property of the insolvent is sufficient to meet him. [Sec. 61 (2) and (3)].

*Note* :—Preferential debts should therefore be paid in priority to all other debts, subject to the retention of the expenses of the Official Receiver for the administration of the estate. Where the insolvents' estate does not permit the payment in full of all the preferential debts, they shall be paid proportionately.

*Payment of non-preferential debts :—*

Subject to the provision of this Act all debts entered in the schedule shall be paid rateably (proportionately) according to the amount of such debts respectively, and without any preference. [Sec. 61 (5)]

*Note:—*After the payment of the preferential debts, all other debts, called *non-preferential debts*, have to be paid to the creditors and if the amount remaining after payment of the preferential debts is not sufficient to discharge all the non-preferential debts in full they will have to abate proportionately.

*Payment of interest :—*

We have already noticed that according to Sec. 48 interest, if not provided by the parties, can be claimed on the debt provable under the Act at 6% only up to the date of adjudication. According to Sec. 61 (6) P. I. Act if there is any surplus left after the payment of the preferential and non-preferential debts in full, it shall be applied in payment of interest from the date on which the debtor is adjudged insolvent at the rate of 6 per cent per annum, on all the debts entered in the schedule.

*Payment of debts due from partnership :—*

Sec. 61 (4) enacts :—

“In the case of partners, the partnership property shall be applicable in the first instance in payment of the partnership debts, and the separate property of each partner shall be applicable in the first instance in payment of his separate debts. Where there is a surplus of the separate property of the partners, it shall be dealt with as part of the partnership property; and where there is a surplus of the partnership property it shall be dealt with as part of the respective separate property in proportion to the rights and interests of each partner, in the partnership property.” Sec. 61 (4).

*Note :—*We have already noticed that Sec. 48 of the Indian Partnership Act 1932 lays down a similar rule, and both these rules are based on the English rule of administration in Bankruptcy that the joint estate be applied in payment of the joint debt, and the separate estate in payment of the separate debts, and any surplus there may be of either, being carried over to the other. According to this rule joint creditors cannot touch the separate estate until after the payment in full of the separate debts, and vice versa.

*Calculation of dividends :*

Sec. 62 enacts:—

“(1) In the calculation of dividends, the receiver shall retain in his hands sufficient assets to meet :—

(a) debts provable under this Act and appearing, from the insolvent's statements or otherwise, to be due to persons resident in places so distant that in the ordinary course of communication they have not had sufficient time to tender their proofs ;

(b) debts probable under this Act, the subject of claims not yet determined ;

(c) disputed proofs or claims; and

(d) the expenses necessary for the administration of the estate or otherwise.

(2) Subject to the provisions of sub-sec. (1) all money in hand shall be distributed as dividends. (Sec. 62.)”

*Right of creditor who has not proved debt before declaration of dividend :—*

Any creditor who has not proved his debt before the declaration of any dividend or dividends shall be entitled to be paid, out of any money for the time being in the hands of the receiver, any dividend or dividends which he may have failed to receive before that money is applied to the payment of any future dividend or dividends ; but he shall not be entitled to disturb the distribution of any dividend declared before his debt was proved by reason that he has not participated there in. (Sec. 63).

*Committee of inspection :—*Sec. 67-A lays down :

“The Court may if it thinks fit authorise the creditors who have proved their debts to appoint a committee of inspection for the purpose of superintending the administration of the insolvent's property by the receiver.

(2) The persons appointed to a committee of inspection shall be creditors who have proved their debts or persons holding general powers of attorney from such creditors.

(3) The committee of inspection shall have such powers of control over the proceedings of the receiver as may be prescribed.” (Sec. 67-A.)

*Miscellaneous provisions relating to distribution of property:* Sec. 65 provides that no suit lies against the receiver for recovery of a dividend, but that where the receiver refused to pay the dividend, the Court may on the application of a creditor who

was entered in the schedule order the receiver to pay it together with interest from the time it is withheld and the costs of the application. The Court may, subject to such terms as it thinks fit, appoint the insolvent himself to superintend the management of his property, or to carry on trade for the benefit of the creditors, or to aid in administering the property. The Court may, from time to time, make such allowance as it thinks just to the insolvent, out of his property, for the support of himself and his family, or in consideration of his services if he is engaged in winding up his estate, and such allowance may be varied or determined by the Court. (Sec. 66.) The insolvent shall be entitled to any surplus remaining after payment in full of his creditors with interest as provided by this Act, and of the expenses of the proceedings taken thereunder. (Sec. 67)

#### Appeals against acts and decisions of Receiver

(Sec.) 68 enacts :

"If the insolvent or any of the creditors or any other person is aggrieved by any act or decision of the receiver he may apply to the Court, and it may confirm, reverse, or modify the act or decision complained of, and make such order as it thinks just, Provided that no application under this section shall be entertained after the expiration of twenty one days from the date of the act or decision complained of. (Sec. 68).

#### Offences by debtors

The following acts or omissions of an insolvent whether made before or after adjudication, are made offences, and he is liable on a conviction by a Magistrate to imprisonment : (1) wilfully failing to perform the duties imposed on him by Sec. 22, or to deliver up possession of his property, which is divisible amongst his creditors ; (2) fraudulently with intent to conceal the state of his affairs or to defeat the objects of the Act (i) has destroyed or otherwise wilfully prevented or withheld the production of any document relating to his affairs which are subject to investigation under the Act, (ii) has kept or caused to be kept false books, or (iii) has made false entries or withheld entries from or wilfully altered or falsified a document relating to his affairs subject to investigation under the Act, (3) fraudulently with intent to diminish the sum to be divided amongst the

creditors or give an undue preference to any of the creditors (i) discharged or concealed any debt due to or from him; (ii) has made away with, charged, mortgaged, or cancelled any part of his property (4). An undischarged insolvent obtaining credit to the extent of Rs. 50 or upwards from any one without informing the facts that he is an undischarged insolvent is also liable to be punished with imprisonment.

*Disqualifications of an insolvent* :—A debtor who is adjudged or re-adjudged insolvent is subject to certain disabilities viz., he shall be disqualified from being appointed or acting as a Magistrate, or elected to any office of any local authority, and being elected or sitting or voting as a member of any local authority. The said disqualification shall cease after the order of adjudication is annulled under Sec. 35, or when he obtains an order of discharge from the Court with a certificate that his insolvency was due to misfortune and not caused by any misconduct on his part. (Sec. 73).

#### Summary Administration

Sec. 74 of the Act provides that if the Court is satisfied by affidavits or otherwise that the property of the debtor is not likely to exceed in value Rs. 500 the Court may make an order that the debtor's estate be administered in a summary manner, whereupon the ordinary procedure under the Act will be modified in respect of the following matters : (i) the Court can dispense with the publication of the fact of adjudication in the Local Official Gazette ; (ii) the Court can direct the vesting of the property to be in the Court instead of Official Receiver, ; (iii) the Court may itself prepare at the hearing of the petition the list of debts and assets of the debtors ; (iv) the Court may distribute the estate in a single dividend ; (v) it may direct the debtor to apply for discharge in 6 months, and (vi) it may make such other modifications with a view to save expense and simplify proceedings. (Sec. 74).

#### Appeals

The following rules are laid down by Sec. 74 :

(i) Any creditor, receiver, or any other person aggrieved by a decision or order of an insolvency Court may prefer an appeal.

(ii) An appeal from an order of a Court subordinate to the District Court shall lie to the District Court, and the order

of the District Court upon such appeal shall be final. But the High Court may in such a case call for the records in the case and pass such order as it thinks fit. Any person aggrieved may also prefer a second appeal to the High Court on any of the grounds mentioned in Sec. 100 C. P. Code.

(iii) Any person aggrieved by any decision or order of a District Court as is specified in Schedule I (*i.e.*, orders under Sec. 4 ; 25 ; 26 ; 27 ; 33 ; 35 ; 37 ; 41 50 ; 53 ; 54 ; 69) of the P. I. Act, made otherwise than in appeal from an order made by a subordinate Court, may appeal to the High Court. In the case of other decision or orders of the District Court, made otherwise than in appeal from the subordinate Courts he may appeal to the High Court after obtaining the leave of the District Court or of the High Court.

(iv) The period of limitation for appeals to the District Court is 30 days and to the High Court 90 days.

#### Power to make Rules

Sec. 79 enacts :

"1. The High Court may with the previous sanction in the case of the High Court of Judicature at Fort William in Bengal, of the Governor General in Council, and in the case of any other High Court, of the Local Government, make rules for carrying into effect the provisions of this Act.

2. In particular and without prejudice to the generality of the foregoing power, such rules may provide :

(a) for the appointment and remuneration of receiver (other than Official Receiver) the audit of the accounts of all receivers, and the costs of such audit,

(b) for meetings of creditors,

(c) for the procedure to be followed, where the debtors is a firm,

(d) for the procedure to be followed in the case of estate to be administered in a summary manner, and

(e) for any matter which is to be or may be prescribed.

3. All rules made under this section shall be published in the Gazette of India or in the local official Gazette as the case may be, and shall, on such publication, have effect as if enacted in this Act " (Sec. 79).



## CHAPTER XXIII

### CARRIERS AND SHIPPING

*Definition* :—A contract of carriage of goods, as already noted, is a contract of bailment for reward *viz.*, *locatio operis faciendi*. A common carrier is one who undertakes for reward to transport from place to place at a reasonable rate the goods of such as choose to employ him. Carriers generally speaking are of three kinds : (1) *voluntary or gratuitous* i.e., those who carry without hire ; (2) *private carriers* i.e., those who do not carry regularly from place to place, but who when required, carry goods for others on payment of hire ; (3) *common carriers* i.e., those who publicly undertake to carry from place to place, either by land, or by water, the goods of any person who chooses to employ them. Common carrier is defined by the Indian Carriers Act 1865 thus : " A person other than the Government engaged in the business of transporting for hire property from place to place by land, or inland navigation, for all persons indiscriminately. ' Persons ' includes any association or body of persons whether incorporated or not." The distinction between private carriers and common carriers is important in English Law because the liability of a common carrier is a part of the Common Law of England, while the liability of a private carrier is determined by contract.

#### Who are Common Carriers

The following are common carriers :

(1) Owners of carriages, barges, and ships, who carry goods from one town to another, or from one country to another; (2) railway and canal companies, in respect of goods which they profess to carry; (3) every one who holds himself out to carry goods for any one as a public employment. It may be noted that a person or a company carrying passengers, cabmen, and the Post Master General are not common carriers. Whether a person or a corporation is a common carrier or not is a question of fact in each case, the test being whether the goods are carried for particular persons only as a matter of special contract reserving to himself the right to accept or reject the goods or for any

one who employs him. *Belfast Rope Work Coy Ltd. v. Bushell*, (1918) 1 K. B. 210. It may also be noted that a person may be a common carrier only in respect of certain kinds of goods.

• In England the law relating to carriers is embodied in the Carriers Act of 1830. The English Common Law relating to carriers was originally applied in our country, but later on certain statutory modifications were made thereto. The Indian Legislature passed the Carriers Act of 1865 dealing with common carriers by inland navigation, and by land, other than railways, which introducing some modifications to the English Common Law. But the law embodied in the Carriers Act is not exhaustive either in regard to the classes of common carriers, nor even in regard to the carriers dealt with by the Act. For instance it does not deal with railways. So the position in India to-day is this : (1) Common carriers by sea are governed by the rules of Common Law of England; (2) Common carriers by inland navigation and by land, other than railways, are governed by the rules of the English Common Law with such modifications as are introduced by the Carriers Act III of 1865 ; (3) Common carriers by railway are governed by the Indian Railways Act IX of 1890, and the English Common Law or the Carriers Act of 1865 has no application to them. It may be noted therefore that with regard to common carriers, other than railways, the Common Law of England has still an important part to play, because it is applied in cases to which the Carriers Act has no application, or when there is nothing in the said Act to the contrary.

#### Duties of Common Carriers at Common Law

At Common Law a common carrier is subject to the following duties :

(1) he is bound to receive and carry all goods of the class he professes to carry ; (2) he is bound to carry such goods of any person who is willing to employ him by paying the proper charges; (3) he is bound to carry the goods safely. In the absence of a contract to the contrary he must carry them by the ordinary or reasonable route, though not necessarily the shortest; (4) he must deliver the goods to the consignee without unreasonable delay, having regard to circumstances; (5) he must deliver them at the place fixed by the consignor, unless the consignee gives

different instructions; (6) if it is usual for the consignee to take delivery at the wharf, or other place of carrier's arrival, the goods must be kept by the carrier at his own risk for a reasonable time, to enable the consignee or his agent to take delivery of the same. His liability terminates after the lapse of such time.

*Note* :—A Common carrier is not bound to carry goods : (i) if he has no accommodation for them; or (ii) if the goods belong to a class which he does not profess to carry ; or (iii) if they are of such a kind as to make it exceptionally dangerous to carry.

### Rights of Common Carriers at Common Law

A common carrier is entitled at Common Law to the following rights :—

- (1) to have the goods delivered to him ;
- (2) to receive the charges in advance i.e., after receiving the goods, but even before he carries them ;
- (3) to receive the prescribed charges, which should be reasonable ;
- (4) particular lien on the goods for the charges, or freight. (Supra).

### Liability of Common Carriers at Common Law

The rule at Common Law is that a common carrier is an insurer of the safety of goods entrusted to him, and is therefore liable for any loss or damage, whether caused by his negligence or not. To this rule the following exceptions are recognised :

(1) Act of God, i e., an accident produced by the elementary forces of nature directly and exclusively, without human intervention, and which no amount of reasonable care could avoid or prevent e.g., lightning, cyclone, unprecedented rain-fall etc., *Nugent v. Smith*, (1875) 1 C. P. D. 423.

(2) King's enemies, e.g., the army of a country at war with England. But this exception does not apply to rioters, robbers or pirates.

(3) Inherent vice or defect in the goods to be carried, e.g., natural decay of fruit or vegetables, or the struggle of animals etc. *Blower v. Great Western Railway Coy.* (1872) L.R. 7 C.P. 655.

(4) Negligence of the consignor in not properly packing them.

*Note:*—These exceptions to Common Law liability would not apply unless : (i) the common carrier has provided fit and safe carriage, and where transit is by water,—a water tight boat has been employed, and (ii) he has followed the ordinary route; and (iii) he has endeavoured to deliver goods in the usual course or according to the agreement. In addition to the Common Law liability of a common carrier which arises under contract, he may be made liable for negligence on the basis of tort.

This liability of a common carrier as insurer exists except (i) in cases and to the extent it has been modified by statute (in England the Carriers Act 1830); or (ii) where the parties make special terms limiting the liability at Common Law, by means of an express contract.

#### Rights and liabilities of different kinds of common carriers in India

(1) Common carriers by sea, or inland navigation, or by land, but not by rail, in the absence of a special contract, are liable as insurers subject to certain recognised exceptions.

(2) Carriers by railway, in the absence of special contract, are liable as bailees only for negligence, as laid down in Secs. 151, 152 and 161 of the Indian Contract Act (Sec. 72 Railways Act). In England railway companies are common carriers of passengers' luggage. *Vosper v. Great Western Railway* (1920) 1 K.B. 346.

#### Limitation of liability by special contract

(1) Carriers by sea may, by means of a special contract, exonerate themselves from liability, even for loss or damage caused by their own negligence or fraud.

(2) Carriers by inland navigation, or by land, but not by rail, can limit their liability as insurer in the case of non-scheduled articles by means of a special contract. But they cannot, even by special contract, get rid of their liability for criminal acts or negligence of the agents or servants. Further the Carriers Act of 1865 requires that the special contract must be in writing signed by the owner of the goods or his agent.

(3) Carriers by railway or railway administration may reduce their liability even below what is laid down in Secs. 151, 152 and 161 of the contract Act by means of a special contract, provided the agreement is in writing and signed by or on behalf of the

person delivering the goods, and is in a form approved by the Governor General in Council.

### Liability in the case of scheduled or excepted articles

1. *Carriers by sea* :—In the absence of a special contract a common carrier is liable as an insurer, even for articles of special value, or of perishable nature.

2. *Railway administrations* :—They are not liable for articles of special value or perishable nature, even if the loss or damage is due to the negligence or criminal acts of the administration, unless they are insured. (Sec. 75).

3. *Common carriers by inland navigation, or by land, but not by rail* :—Sec. 3 of the Carriers Act of 1865 lays down that no common carrier shall be liable for the loss of or damage to property delivered to him to be carried, exceeding in value Rs. 100, and of the description contained in the schedule to the Act (gold and silver coin, gold and silver in a manufactured state, precious stones, jewellery, currency notes, title deeds, glass, China silk, clothes and tissues embroidered with precious metals, articles of ivory etc.) unless the person delivering such property or his agent has expressly declared to such carrier, or his agent the value and the description thereof. For undertaking the risk involved in carrying these excepted articles exceeding Rs. 100 in value, the common carrier may require payment at such rate or charge as he may fix. The carrier should exhibit at the place where he carries on business, notice of the higher rate of charge required by him printed in English, and in the vernacular language of the country. It may therefore be noted that the Carriers Act of 1865 has introduced two important modifications to the English Common Law viz., (i) it enables the common carrier to limit his extraordinary liability as an insurer for the safety of the goods, by entering into a special contract with the consignor. Notwithstanding such special contract he cannot escape liability in case of loss or damage resulting from his negligence or criminal act; (ii) it has also afforded protection to the carriers in the case of small articles of great value, or articles of unusually perishable character, by requiring their value to be declared and an additional sum paid for the risk undertaken.

### Shipping or Carriers by Sea Contract of affreightment

A contract of affreightment is a contract by which a ship-owner undertakes to carry the goods of another, in consideration of a remuneration called freight. This type of contract may be one of two kinds : (i) Charter-party ; and (ii) Bill of lading. The rights and liabilities of parties to a contract of affreightment are regulated, subject to any stipulations in the contract, by common law and statute. In England until recently the parties to such contracts enjoyed complete freedom in making them but the Carriage of Goods by Sea Act 1924 has imposed some restrictions in the case of bills of lading, preventing the carrier from exonerating himself from liability absolutely, by the terms of his contract, for non-delivery, or loss cargo, or from damage thereto.

#### Charter-party

A charter-party is a contract in writing by which an entire ship, or some principal part of a ship, is let to a merchant for the conveyance of his goods. A bill of lading on the other hand is in most cases a document evidencing a contract by which a ship owner agrees to carry goods for a merchant on a general ship for a definite voyage. It is also a receipt for the goods which have been entrusted to the ship owner, and a document of title to goods.

A charter-party may, but need not necessarily be under seal, but it must be stamped. It may amount to a complete demise (letting) of the ship, that is to say it may put the entire vessel out of the power and control of its owner, and vest their power and control in the person whose goods are to be carried, (called the *charterer*) so that during the hiring the ship is to be regarded as the vessel of the charterer and not of the owner. But generally the ship remains in the possession of the owner, while the charterer acquires only the right to put his goods on the vessel and to have them carried. The question is one of construction of the contract in each case. A charter-party may be either (i) *a voyage charter* i.e., the letting of the ship is for definite voyage or voyages or (ii) *a time charter* i.e., the letting of the ship is for a fixed time.

A charter-party in the case of voyage charter generally contains the following undertakings and clauses :

(i) that the ship is at a particular port at the time of the contract. This is an important statement and it is generally construed as a condition precedent, so that its falsity entitles the charterer to rescind the contract;

(ii) sea worthiness and fitness of the ship. The ship owner when he enters into a charter party for a voyage impliedly warrants not simply that he has done his best to make the ship fit, but also that the ship is actually sea worthy, and fit to receive the cargo and encounter the ordinary perils of navigation during voyage. This warranty extends only to : (a) sea worthiness at the time of sailing, and (b) to fitness at the time of loading the cargo. It does not continue to exist after the ship has sailed, or the goods are once on board. If however the voyage is divided into stages for the purpose of taking in coal etc., the vessel must be made sea worthy at the commencement of each stage. It is also an implied condition that the voyage shall be commenced and carried out without unreasonable delay, and that there shall be no unnecessary deviation ;

(iii) that the ship shall proceed with all convenient speed and load the cargo;

(iv) that the ship owner shall take his ship to the agreed or usual place of loading at the port where the voyage is to commence, unless the charter-party makes provision otherwise. It is the duty of the charterer to bring his goods along side of the ship at such place and deliver them to the servants of the ship owner. The charterer will be liable, in the absence of stipulation to the contrary, if he fails to produce the cargo even though he is not at fault. It is the duty of the ship owner to properly stow the cargo inside the ship but there are numerous exceptions to this rule.

(v) *a full and complete cargo* : A charterer is under an obligation to supply a full and complete cargo which means that he must load as much cargo as the ship consistent with her safety, is able to carry according to the custom of the port of loading. Goods cannot be carried on deck unless they are of such a description as is usual to be so carried.

(vi) *deliver the cargo in the usual manner*: The ship owner has to bring the ship to the named place where the voyage is to end, and keep her ready with all reasonable despatch to dis-

charge in the usual or stipulated manner. It is the duty of the charterer or the consignee to take the cargo from along side the ship, and for that purpose provide proper appliances for taking delivery there. The ship owner has to put the cargo on the rail of the ship and in such a position that the consignee can take it. In default of taking delivery of the cargo at the time agreed, or if no time is agreed, within 72 hours, exclusive of a Sunday or a holiday, from the time of the report of the ship, the ship owner may, land the goods and place them at certain places according to circumstances. The ship owner notwithstanding such landing would retain his lien for freight on the same, and may, subject to certain conditions, sell the goods by public auction to satisfy the customs due, expenses and the freight.

(vii) *lay days and demurrage*: 'Lay days' means the time which is allowed to the charterer for the purpose of loading and unloading the cargo. Where no time is agreed upon the law implies a reasonable time, having regard to the custom of the port and the existing circumstances. Where the number of lay days are exceeded the charterer becomes liable to pay the ship owner what is called 'demurrage'. It properly signifies the agreed additional payment (usually per day) for an allowed detention of the ship while loading or unloading beyond the period specified in the charter-party. It also means compensation by way of unliquidated damages for undue detention not provided for specifically in the charter-party.

(viii) *cesser clause*: Charter parties generally contain a clause putting an end to the charterer's liability when the cargo is loaded, the ship owner relying on his lien in order to get payment. This clause is inserted only in consideration of the ship owner getting a lien on the cargo for freight as well as demurrage. Therefore where there is no lien on the cargo in favour of the ship owner, this clause would not preclude the ship owner from recovering the demurrage due to him from the charterer.

(ix) *excepted perils and negligence clause*: Charter parties usually contain a clause exonerating the ship owner from liability for loss occasioned by the causes enumerated therein, provided it is not due to the negligence on the part of the ship owner, or of those for whom he is responsible. The causes in respect of which liability is excepted are: (i) Act of God (already defined) (ii) King's enemies, (iii) restraint of princes and rulers, and (iv) perils



(dangers and accidents) of the sea. It may be noted that this clause would not protect the ship owner if the ship is unseaworthy at the commencement of the voyage, or when the ship has without any justification deviated from the ordinary route of voyage.

### Bill of Lading

*Definition:* A bill of lading is a document acknowledging the shipment of goods signed by or on behalf of the carrier, and containing the terms and conditions upon which it has been agreed that they are to be carried. As stated at the outset it is evidence of the contract for the carriage of goods on a general ship i.e., a ship which is used for the carriage of goods of several merchants who wish to have them conveyed by her, and which is not employed for the carriage of a charterers' goods only. A bill of lading may be used even where the ship is chartered. In such a case the charter-party will be the document evidencing the contract of affreightment, while the bill of lading would only operate as a mere acknowledgment of the receipt of the goods. The legal character of a bill of lading is therefore three-fold: (i) it is a receipt for the goods shipped incorporating the terms on which they have been received; (ii) it is evidence of the contract for the carriage of goods; (iii) it is a document of title to the goods specified therein. A bill of lading issued in connection with the carriage of goods by sea in ships from any port in Great Britain or Northern Ireland must conform to the Carriage of Goods by Sea Act 1924. This Act lays down that in the cases in which it applies there is no absolute warranty of sea worthiness, but every bill of lading is made expressly subject to the rules laid down in the schedule to the Act, and prevents the carrier from exonerating himself from liability altogether. It may be noted that the Indian Carriage of Goods by Sea Act, XXVI of 1925 applies the rules laid down therein, with some modifications, to and in connection with the carriage of goods by sea in ships carrying goods from any port in British India to any other port whether in or outside British India.

### Form and contents of Bill of Lading

Generally a bill of lading contains the following particulars:

- (1) name of the ship and the master thereof;
- (2) the port in which the ship is at the time of contract;

- (3) the port for which it is bound;
- (4) description of the goods shipped;
- (5) excepted perils clause;
- (6) the amount of freight.

The bill of lading should be signed by the master of the ship and should be stamped. In practice, at the outset, a less formal receipt called *mates receipt* will be given which will afterwards be exchanged for a bill of lading signed by the master.

The effect of some of these clauses has been already noticed in connection with charter-parties. It may be noted that in the case of a charter-party a shipowner may have some duties to perform even before the goods are shipped, but that is not so in the case of a bill of lading.

#### Clean Bill of Lading

When the shipowner admits in the bill of lading that the goods shipped are in good order and condition, it is called a clean bill of lading. In such a case, the shipowner is precluded from contending later on that the goods were not in good condition and order when they were put on board. *Brandt v. Liverpool etc. Steam Navigation Co.* (1924) 1 K.B. 575.

#### Whether bill of lading is a negotiable instrument

Business men generally speak of a bill of lading as a negotiable instrument, but in the strict legal sense it is not. It is no doubt possible to transfer the title to the goods represented by a bill of lading by endorsement and delivery of the same. In order that it may be a negotiable instrument a further condition should be satisfied viz., that a transferee of such an instrument, if he happens to be a holder in due course, should be able to obtain a better title than that possessed by the transferor. But that is not so in the case of a bill of lading. Further a negotiable instrument is a contract to pay money, but a bill of lading empowers its holder only to obtain goods represented by it. Therefore even though a bill of lading can be transferred by endorsement and delivery, it is not correct to call it a negotiable instrument.

#### Bill of lading a document of title

A bill of lading is a symbol of the goods, and a transfer of it is symbolically a transfer of the goods themselves. We have

already noticed that a bill of lading is included in the definition of a document of title to goods by the Sale of Goods Act. Property in the goods represented by a bill of lading will therefore pass by an endorsement and delivery. It is therefore very rightly remarked that a bill of lading is a key which in the hands of the rightful owner is intended to unlock the door of the ware-house floating or fixed, in which the goods may chance to be. It may be noted that in England the Bills of Lading Act lays down that an endorsee of a bill of lading obtains not only a title to the goods mentioned therein but shall, subject to the right of the unpaid vendor to stop the goods in transit, and the right of a ship owner in respect of the goods for his freight, have transferred to and vested in him all rights of suit, and be subject to the same liability in respect of such goods as if the contract contained in the bill of lading had been made with himself. Similar rules have been laid down by the Indian Bills of Lading Act IX of 1856.

**Freight**—is the consideration paid to a carrier for the carriage of goods. It is payable only if the voyage has been completed and the goods delivered, unless non-delivery is caused by the fault of the shipper alone, or by the perils excepted in the charter-party, or bill of lading.

**Advance Freight**—is freight payable before the delivery of the goods as per the stipulation. Even if it is not paid, it can be recovered by the shipowner from the charterer upon the loss of the ship. It depends upon the circumstance whether a given payment is intended as an advance freight, or as a loan. Simply because a payment is called freight in advance, it is not conclusive of that fact.

**Lump sum freight**—is the entire sum which has to be paid for the use of the ship for one entire service. It is payable when the goods are shipped. The whole freight becomes payable even by delivering a part of the cargo, provided the non-delivery of the remainder is due to an excepted peril. *Thomas v. Harrowing S. S. Company* (1915) A.C. 58.

**Pro-Rata Freight**—is the name given to a payment which is sometimes made for carriage of goods when the contract has been performed in part only.

### Shipowner's lien

At common law every shipowner possesses a lien upon the goods which he carries, until he has received payment of freight. The lien terminates upon delivery of the goods, but it extends to all the property consigned on the same voyage under the same contract under which the freight is due, so that a delivery of a part of the goods does not defeat the lien on the remainder. The lien attaches only when the freight is payable on delivery, and it therefore does not exist in the case of : (i) advance freight, or (ii) freight agreed to be paid after delivery of the goods. But these rights at common law can be modified by agreement between the parties. The lien is enforced merely by retaining the goods. The Merchant Shipping Act of 1894 lays down that if the lien is not discharged a power of sale is given after the goods have been warehoused for 90 days, subject to the conditions laid down in that section.

### General and Particular Average

During a sea voyage a risk is generally undertaken in respect of three interests : (i) the ship (ii) the cargo and (iii) the freight. From the stand point of the interest which suffers risk an average may be one of two kinds ; (a) Particular average, or (b) General average. *Particular average* is loss caused to the property of an individual by accident or otherwise, which is not suffered for the general benefit, e.g. loss of an anchor, or damage by water to cargo. In the case of particular average generally it is the particular interest that sustains the loss that must bear it. Where however an extraordinary expenditure is incurred or sacrifice made for the benefit of the whole adventure, the loss has to be borne by all the interests proportionately, and it is called a *general average* loss. In such a case the loss that is suffered by the particular interest is entitled to what is called *general average contribution* from the other interests. Examples of general average loss are : (i) damage to cargo by scuttling the ship to extinguish fire; (ii) expenses of putting into a port of refuge for the preservation of the ship and cargo; (iii) voluntary stranding to avoid risk.

A general average contribution is made by all who have been benefitted by general average acts. They are :

(1) the shipowner in respect of the ship and the freight payable under the charter-party, if any, or under the bills of lading, if there is no charter-party; (2) the charterer in respect of the freight payable under the bills of lading; (3) the owner of the cargo in respect of the cargo. The liability to contribute is enforced by the owner of the ship on behalf of all the interests aforesaid, by exercising the lien over the cargo. In default of the shipowner exercising the lien he is liable to be sued for contribution by those entitled to it. In order that a general average contribution may be claimed the following conditions must be satisfied : (i) the sacrifice must have been incurred to avoid a danger common to all interests; (ii) the sacrifice must have been necessary under the circumstances; (iii) it must be a voluntary and a real sacrifice; (iv) the ship, the cargo, or the freight must have been actually preserved thereby; (v) the danger must not have arisen on account of the default of the person claiming the general average contribution. It may be noted that any extraordinary expenditure incurred by a shipowner in connection with an extraordinary occasion e.g., an abnormal consumption of coal in attempting to refloat a ship stranded in a position of peril, is also the subject of general average contribution.

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## CHAPTER XXIV

### INSURANCE—LIFE, FIRE, MARINE, MOTOR VEHICLES (THIRD PARTY)

#### Introduction

*Definition :* Insurance is a contract either to indemnify against a loss which may arise upon the happening of some event, or to pay on the happening of some event a sum of money to the person insured. The instrument containing the contract to insure is called a *policy of insurance*, the person insured is called the *assured* or *insured*, and the person who insures is called the *insurer*, *assurer*, or *under-writer*, the last word being generally used in a case of marine insurance.

The broad classification of contracts of insurance is :  
(1) marine and (2) non-marine.

Non-marine insurance may be either :

(1) Personal insurance, in which the person of the assured is affected. It includes life assurance, personal accident insurance, and sickness insurance.

(2) Property insurance in which the property of the assured is affected. It includes fire insurance, fidelity insurance etc.

(3) Liability insurance, in which the event results in liability. It includes motor vehicle insurance and all other insurances against liability.

There is thus no limit to the varieties of insurance, but it is proposed to deal only with the important kinds of insurance *viz.*, (1) Life, (2) Fire (3) Motor vehicles insurance (third party risks) and (4) Marine insurance.

#### General Principles applicable to non-marine insurance

*Nature of the contract:* It has been noted *supra* that contracts of insurance are contracts of indemnity, because a typical contract of insurance involves an obligation on the part of the insurer to pay a sum of money to the assured upon the happening of an uncertain event. But there are some contracts of insurance which are not however contracts of indemnity. Thus marine

insurance, and fire insurance, are contracts of indemnity but life assurance and personal accident insurance are not contracts of indemnity. Where the insurance is a contract of indemnity the happening of the event does not by itself entitle the insured to the payment of the sum insured. The event must result in a pecuniary loss to the insured, when alone he becomes entitled to be *indemnified*, subject to the terms of his contract. Further the insured can recover no more than the sum insured, for that sum fixes the maximum liability of the insurer, and even that amount cannot be recovered unless it represents the actual loss sustained by the insured. In other words the contract being one of indemnity, the insured can only recover the amount of his loss and no more. *Dalby v. India and London Life Assurance Co.*, (1854) 15 C.B. 365. Contracts of life assurance are not contracts of indemnity, but in a way constitute a form of investment. In these cases there is no necessity to prove a pecuniary loss, and the moment the event happens—whether it be the attaining of a particular age, or death, whichever is earlier, as in the case of an endowment policy, or death as in the case of a whole life policy—the sum insured becomes payable.

### Insurance—a contract of good faith

All contracts of insurance, marine as well as non-marine, are contracts *uberrimae fidei* i.e., contracts of utmost good faith. These contracts proceed on the basis that every material fact is disclosed, so that the non-disclosure of a material fact entitles the other party to avoid the contract. Whether the omission to disclose any particular fact or circumstance is material or not, so as to render the contract voidable, is question of fact in each case, *Mutual Life Insurance Co. of New York v. Ontario Metal Products Co.* 1925 A.C. 344. This duty to disclose material facts is mutual, although the occasions for disclosure by the insurer are very rare, as the facts material to the insurance are generally not known to the insurers, but known only to the assured. The duty of disclosure however comes to an end when the contract is complete, and material facts which come to the knowledge of the assured subsequently need not be disclosed. But a new material fact which arises at any time during negotiations, or a fact which though previously not material becomes material owing to

change of circumstances, must be disclosed as soon as it becomes apparent to the assured; e.g. a refusal by other insurers to renew an existing policy, if given during the negotiations, is material and must be disclosed; or if pending acceptance of a proposal for life assurance the assured sustains a serious injury by accident, that fact is also material and must be disclosed.

In non-marine insurance the assured is generally required to fill up and sign a printed form of proposal in which particulars of the proposed insurance are stated. The form is prepared by the insurers, and it contains a series of questions regarding: (1) the personal particulars of the assured; (2) particulars of the risk to the assured; (3) circumstances affecting the risk; (4) previous experience of the assured; and (5) previous insurance record of the assured. The answers furnished by the assured regarding these particulars form the basis on which the insurers accept or reject the proposal, and the assured in giving these answers will be acting pursuant to his duty to make a full disclosure. It is therefore necessary that the answers given should be substantially accurate though not absolutely true in all details. Very often a proposal form contains a declaration signed by the assured to the effect that the statements contained therein are true, and that they form the basis of the contract between the parties. In such a case the truth of the answer is made a condition precedent to the validity of the policy, which will be rendered voidable by any inaccuracy, even if it be in respect of an immaterial detail.

#### Cover notes and agreements to insure

In order that there may be a binding contract of insurance there must be a completed agreement as to all its terms. In the case of a printed proposal form, which is generally supplied by insurers in the case of non-marine insurance, the contract will be completed only upon the acceptance of the proposal by the insurers. Until acceptance they are not bound, and they are at liberty to introduce fresh terms constituting a counter offer, which the assured must accept before there can be a binding contract. Pending the acceptance of the proposal by the insurer in a formal manner by the issue of a policy, the insurers may agree to grant the assured *cover*, whereby he is protected until the fate of the proposal is decided. It may be oral, or may be embodied in a formal document, called a *cover note*. After the policy is issued the



cover note is superseded. During the currency of the cover note the parties are governed only by its terms, and not by the terms of the policy, unless the parties agree that they shall be bound even in respect of the cover note by the terms of the policy.

### The policy of insurance

Though there is no statutory provision, a contract of non-marine insurance is generally expressed in a document called a policy, but in law an oral contract of non-marine insurance appears to be valid. The word 'policy' is applied to the formal document which is used in the course of insurance business to express the contract of the insurers. Generally all policies of non-marine insurance adopt the same form, though they may vary in some details. The policy though in form a unilateral undertaking by the insurers to pay the sum insured, upon the happening of some specified event, it is the exclusive record of the contract inter parties containing the terms and conditions on which the contract is entered into, and its terms are therefore equally binding upon the assured.

### The premium

The premium is the consideration for the insurance, and its amount is measured by the estimate of the risk formed by the insurers upon an average of their previous experience, of similar risks, together with an allowance for office expenses and other charges and profit. There cannot be a contract of insurance unless and until the premium is agreed. In the event of the assured's death any premium due at the date of his death may be paid by his legal representatives, except in cases where the policy contemplates a payment only by the assured. The assured becomes liable to pay the premium as soon as the contract is concluded. But a failure to pay the premium does not exonerate the insurers from their liability under the contract, unless the contract provides otherwise. In practice however payment of the premium in advance is generally made a condition precedent to any liability attaching to the insurers, in which case the assured cannot recover for a loss which happens before the premium is paid. The premium is often payable in instalments, and the policies generally provide that they lapse

unless each instalment is paid on the due date, or within the days of grace allowed. The assured is entitled to claim a return of the premium when there is a failure of consideration arising from the contract, *viz.*, (1) when there is no binding contract of insurance at all e.g. when the contract is void or voidable, or (ii) where there is not anything at risk e.g., the life insured dying before commencement of the insurance. But once the risk is attached, the insurer cannot be compelled to return the premium. A policy which lapses owing to non-payment of the premium may be revived at any time by mutual consent of the parties, but on revival there is a fresh contract and it does not cover a loss happening before such revival.

### Subrogation

The rule of subrogation being a corollary to the principle of indemnity, applies to all contracts of non-marine insurance which are contracts of indemnity, (*supra*).

Subrogation is the right of the insurers to enforce, for their own benefit, all the rights and remedies which the assured possesses against third parties in respect of the subject matter. If those third parties are also insured, the ultimate liability for the loss may fall upon the insurers. The right of subrogation does not arise until the insurers have admitted their liability to the assured and have paid him the amount of the loss. It is available whether the third party is liable to the assured on the basis of a contract, or on the basis of a tort. It is available whether the loss is total or partial. As noticed *supra* the right of subrogation cannot be enforced unless the insurer obtains from the assured a formal assignment of his right of action against the third party. It may be noted that the doctrine of subrogation does not apply to contracts of life assurance and personal accident insurance, which are not contracts of indemnity.

### Double Insurance

Some times the assured may effect insurance with two or more insurers in respect of the same risk, when it is called double insurance. If the two policies together cause an over insurance the excess cannot be recovered, but the assured may sue on whichever policy he desires, and recover the whole sum to which he is entitled by way of indemnity. In practice every proposal

for non-marine insurance contains a question requiring information regarding the existing insurances. The effect of double insurance, in cases where the contract of insurance is one of indemnity (*i.e.* other than life and personal accident) is, that the insurer, in the absence of a condition to the contrary in any of the policies, may recover in full the loss suffered by him by enforcing any of the policies. But the insurer who is so made liable can claim contribution from his co-insurers. In practice many policies of non-marine insurance contain what is called a '*contribution clause*' restricting the liability of the insurer in case of double insurance, to a rateable proportion of the loss. In such a case the assured cannot recover the payment in full under anyone policy, because each of the policies is liable only for its rateable proportion.

*Average clause*: Policies insuring mercantile property, and particularly fire policies, generally contain what is called 'an average clause', which provides that if at the time of the loss the sum insured is less than the value of the property, the assured is to be considered as his own insurer for the difference, and should bear a rateable proportion of the loss accordingly. Non-marine policies are not, in the absence of the stipulation to the contrary, subject to the rule of average clause, and an assured is not therefore prejudiced by reason of under-insurance, and can recover the full amount of the loss, whether total or partial, up to the sum insured.

*Points of difference between marine and non-marine insurance*: Though the general principles underlying both marine and non-marine insurance are the same, there are some important points of difference between the two, which are noted below:

(1) In marine insurance it is not the practice of insurers to ask any questions. They rely for their protection on the common law duty of disclosure. In the cases of non-marine insurance there is generally a printed form containing questions which have to be answered, and which are considered by the insurers as material to the contract.

(2) Marine insurance differs from life and personal accident insurance, in that the former is always a contract of indemnity whereas the latter are not. It is for this reason that in the case of marine insurance the assured cannot recover, unless he has an insurable interest at the time of the loss, though he

might not have had such interest at the commencement of the risk; while in the case of a life assurance the assured need have an insurable interest only at the commencement of the risk, and need not retain it until the death of the life assured. Further the rights of subrogation and contribution, which are rights attaching to contracts of indemnity, are applicable to contracts of marine insurance, but not to life or personal accident insurance.

(3) Contract of marine insurance must be in writing and duly stamped, while contracts of non-marine insurance can be made even orally.

(4) A contract of marine insurance may be ratified by the insurer after the occurrence of the loss, while a contract of fire insurance cannot be ratified.

(5) The amount recoverable under a policy of marine insurance depends on the value at the commencement of the risk, and the value at the time of the loss. In non-marine insurance it depends on the value at the time of the loss.

(6) A policy of non-marine insurance is not subject to average, in the absence of an express term to that effect, but a policy of marine insurance is subject to average as a matter of course.

(7) A voyage policy of marine insurance may be avoided even by a deviation from the voyage insured, but in the case of non-marine insurance the effect of an alteration of the risk depends upon the nature of the alteration, and the terms of the contract.

### Life Insurance

*General* :—The law relating to insurance has been consolidated and amended in our country by the Insurance Act IV of 1938, as amended by Act XLI of 1939. The said Act came into force on the 1st July, 1939 and it has repealed the Provident Insurance Societies Act V of 1912, Indian Life Assurance Companies Act VI of 1912, and the Indian Insurance Companies Act XX of 1928. It is not however a complete code of the insurance law. For instance the Act has not even defined the phrases contract of insurance, insurable interest, nor other terms used in the law relating to insurance. Further it has made very few changes in the existing substantive law relating to insurance. The English law

relating to insurance has therefore to be studied as a necessity, but it may be done with great profit and advantage.

### Principal changes affected by the Act

The following are some of the important changes introduced by the Insurance Act of 1938 :

(1) Sec. 45 lays down that a policy of life insurance effected after the commencement of the Act shall not, after the expiry of two years from the date on which it was effected, be called in question on the ground of a mis-representation in the proposal for insurance, or in any medical report etc., unless it is shown by the insurer that it was on a material matter, and it was fraudulently made by the policy holder with the knowledge of its falsity. In the case of policies effected before the Act came into force, the said period of two years has to be reckoned from the date of the commencement of the Act.

(2) Sec. 46 enacts that a holder of a policy, which is issued in respect of insurance business carried on in British India, is entitled to sue in this country, notwithstanding anything to the contrary in the policy.

(3) It has also laid down that questions of law arising in connection with such a policy shall be determined according to the law in force in British India.

(4) Sec. 47 lays down that in the case of conflicting claims in respect of a policy the insurer shall, before the expiry of 9 months from the date of maturity of the policy, deposit the amount into Court, and a receipt granted by such Court shall be a satisfactory discharge to the insurer for payment of such amount.

The other provisions of the Act of 1938 are largely administrative in scope and intent.

*Life insurance contract defined* :—Insurance upon a life is a contract by which the insurer, in consideration of a certain premium, either in a gross sum or by annual payments, undertakes to pay to the person for whose benefit the insurance is made, a certain sum of money or annuity on the death of the person whose life is insured. If the insurance be for the whole life (when the policy will be called a *whole life policy*) the insurer undertakes to make the payment whenever the death happens. Sometimes the insurer may undertake to make the payment in case the death

should happen within a certain period, for which period the insurance is said to be made. Sometimes the amount is made payable either at death, or at the expiration of a stated number of years, whichever shall first happen, in which case the policy is called an *endowment policy*. The life that may be insured may be the life of the assured himself, or that of a third person.

*Note* :—An objection is often taken to style contracts of insurance upon life as life insurance. The object of these transactions is not to insure a man's life, nor his death, nor are they in the nature of an indemnity to him, for he does not in the event of the loss viz., death, survive to enjoy the fruits of his premium. It is therefore more correct to say that in the case of life, something is "assured" rather than "insured" and that something thus assured is the payment of a particular sum of money, either to the nominee or the assigns of the assured, or to his estate after his death. It is for these reasons that insurance relating to life is rightly called life assurance but not life insurance.

### Suicide

The event which under an ordinary policy of life assurance gives the right to payment, is the death of the assured during the currency of the policy, whatever may be the cause of death, whether it be natural or accidental, or even by a criminal act of himself or of a third person. The insurers therefore provide for an exception to their liability in the case of suicide, or as it is said if the assured 'die by his own hands'. In such cases the insurer can avoid the policy, whether the assured was sane at the time of committing suicide, or even if insane, he knew what he was doing, and was capable of appreciating the consequences. On the other hand if the assured was so insane at that time that he was incapable of appreciating the nature of his act, his self-destruction is not intentional and the exception does not apply. Nothing however prevents an insurer by means of suitable terms in the policy from exonerating himself from liability in all cases of self destruction, *i.e.*, even when the assured was totally insane at the time.

Sometimes the policies provide that they would become void only if the assured committed suicide within a particular period from the date of the policy, and that thereafter even if he kills

himself while in a sane or insane condition, the insurer will be liable. In such cases it has been held that, notwithstanding that clause in the policy, the sum assured cannot be recovered, if the assured committed suicide at a time when he was sane. *Beresford v. Royal Insurance Co.* (1938) A. C. 586.

In *Beresford's* case the policy provided that even if the assured killed himself while in possession of his senses at any time after lapse of one year from the date of the policy, the insurer would pay the sum assured. The assured killed himself after one year while in a sound state of mind. It was held in a suit by the widow of the assured, as his personal representative, that deliberate suicide being a crime in England, the contract was un-enforceable in a Court of law, and that she could not therefore recover.

In *Northern India Assurance Co. v. Kanhayalal*, I.L.R. 1938 Lah. 542, the policy contained a condition that if the assured committed suicide before the policy had been in existence for one year, it would be void. One year after the policy was issued the assured assigned it in favour of his son, and 10 months thereafter the assured committed suicide while in possession of his senses. In a suit by his son (the assignee) it was held by the Lahore High Court, that the committing of suicide is not a crime in India and that the rule of English law laid down in *Beresford's* case has no application in our country, and that the insurers were therefore liable.

The correctness of this decision of the Lahore High Court is open to doubt because even in India attempted suicide and abetment of suicide are crimes according to the Indian Penal Code, and suicide is condemned according to the personal law of Hindus as well as Mahomedans. Therefore if a policy of life insurance contains an agreement to pay the sum insured, even though the assured commits suicide while sane, it must be considered as an agreement opposed to public policy, within the meaning of Sec. 23 of the Indian Contract Act, and the insurers ought not to be made liable.

Where the policy is silent in regard to insurer's liability in case of suicide of the assured, the insurer would be liable only if the assured commits suicide while insane, but not otherwise.

The onus of proving suicide is upon the insurers, and where the cause of death is not known the presumption is against suicide and the policy cannot be avoided.

If a person causes the death of the assured under circumstances which would amount to a crime *e. g.*, by murdering him, the murderer is not entitled to recover the insurance money on the ground of public policy.

### Circumstances affecting risk

Though every one is bound to die, the date when death takes place in the case of a given individual is an uncertain event. But

as the contract of life assurance is based upon the average duration of human life, it becomes obvious that facts which tend to suggest that the life assured is likely to fall short of the average duration, are material facts. and the details which are required in the proposal form should therefore be answered fully and faithfully. The following are circumstances about which the insurers require information for accepting or rejecting the proposal, and also for fixing the premium in case the proposal is accepted :— (i) the age of the life insured, (ii) his health, (iii) his habits and pursuits of life, and (iv) his previous history regarding his health.

### Insurable interest

It has already been noted (*supra*) that a contract of insurance, differs from a contract of wager, because in the case of the former the law requires the existence of an insurable interest to support it, which is not necessary in the case of a wagering contract. In England the Life Assurance Act 1774 lays down that an insurance effected by the assured upon the life of a third person for his benefit, or upon his own life for the benefit of a third person, is void unless supported by what is called an insurable interest. An insurable interest means that the person affecting the insurance will sustain some pecuniary loss on the happening of the event insured against, viz., the death of the person whose life is insured. Any one who has a pecuniary claim against the other, or a legal right to support from him, has an insurable interest in the life of that other. In the case of life assurance insurable interest need subsist only at the time when the insurance is made, and it need not be continuing on the date of the death of the insured, because as already seen life assurance is not a contract of indemnity but only a form of investment. The law recognises an insurable interest in the following cases;

(i) A person has an insurable interest in his own life.

(ii) A husband in the life of his wife and vice-versa. *Griffiths v. Fleming* (1909) 1 K. B. 805. It may be noted that other relations like parents, children, brothers and sisters etc., have, as such, no insurable interest in the other's lives. If therefore an insurable interest is sought to be established in those cases, some kind of pecuniary obligation must be proved e.g., that the parent was supporting the child. *Howard v. Refuge Friendly Society* (1886) 56 L. T. 644.



(iii) Creditors in the lives of their debtors. *Dalby v. India and London Life Assurance Co.*, (supra).

(iv) A surety in the life of the principal debtor, and joint-debtors in each other's lives to the extent of half the debt. *Brarford v. Saunders*. 1877 (25 W. R. 651).

(v) A master in the life of his servant and vice-versa.

(vi) One partner in the life of another partner.

(vii) A trustee having a legal interest in the life of another, may insure it.

According to the English Life Assurance Act 1774 whenever a person effects an insurance on the life of another, he must state in the policy the name of the person interested therein, or for whose benefit or use or on whose account the policy is made. No such duty is imposed by the Indian Act. But as a matter of practice insurers in India insert all those particulars in a schedule attached to the policy. Neither the Indian Contract Act nor the Insurance Act deal with the question of insurable interest, and the principles applicable thereto. But it is well established that the law in England in this regard equally applies to India.

#### Principle of Uberrimae Fidei

The contract of life assurance like other forms of insurance is a contract *uberrimae fidei*, and therefore full disclosure must be made to the insurer by the assured of every fact which is likely to affect his mind in deciding whether to accept or reject the risk (supra). In the event of any concealment of such a fact the policy is rendered voidable. *London Assurance Co. v. Mansel* (1879) 11 Ch. D. 363. Whether the omission to disclose any particular is or is not such as to render the contract voidable is a question of fact in each case. It has already been noticed that according to Sec. 45 a policy of life insurance effected after the Act came into force shall not, after the expiry of two years from the date on which it was effected, be questioned by an insurer on the ground that a statement made in the proposal, or report of medical officer or any other document leading to the issue of the policy was inaccurate or false, unless the insurer shows that such a statement was on a material matter, and fraudulently made by the policy holder with the knowledge that the statement he was making was false. In the case of policies effected before the Act

came into force the insurer must question it within two years from the date of the commencement of the Act.

### Assignment and Nomination

An interest in a policy of insurance is property, in the wide sense of the term, and is an actionable claim, and can be assigned. *Assignment* is the method by which property can be transferred either by gift or by sale. It has the effect of directly transferring the rights of the transferor in respect of the policy, and thus it is a transaction which has to be done in accordance with law. The mode of transferring rights under a policy of life assurance are to be found in Secs. 130, 131 and 132 of the Transfer of Property Act, while Sec. 135 deals with assignment of rights under policies of marine and fire insurance. It should however be noted that Sec. 38 of the Insurance Act governs all assignments of life insurance policies made on or after 1-7-1939, and that Secs. 130 to 132 therefore govern the assignment of life policies made before that date.

On the other hand a *payee* or a *nominee* in respect of the monies payable under a policy of life insurance is an agent to receive that sum. It remains the property of the assured, and will be at his absolute disposal during his life time, and forms part of his estate on his death, the payee or the nominee taking no beneficial interest in it. To this rule Sec. 6 of the Married Women's Property Act III of 1874 is an exception (*infra*). Thus *nomination* is an act revokable in its nature, but an *assignment* has the effect of directly transferring the rights of the transferor in respect of the policy of insurance transferred, and it cannot be undone at the will of the transferor, but can only be done in due course of law.

### Assignment of Life Insurance Policy

According to Sec. 130 of the Transfer of Property Act, the transfer of an actionable claim (which includes a policy of life assurance) can be effected only by the execution of an instrument in writing signed by the transferor or his agent. Thereupon all the rights and remedies of the transferor shall vest in the transferee, whether notice of such transfer is given or not. The transferee can sue or institute proceedings for the same in his

own name, without obtaining the transferor's consent and without making him a party thereto. Sec. 131 of the same Act requires that every notice of transfer of actionable claim shall be in writing signed by the transferor or his duly authorised agent, or in case the transferor refuses to sign the notice, signed by the transferee or his agent, and it shall state the name and address of the transferee. According to Sec. 132 the transferee of an actionable claim shall take it subject to all the liability and equities to which the transferor was subject in respect thereof at the date of the transfer. Where the notice as stated above is not given, or where the debtor is not a party to the transfer, any dealing with the debt or actionable claim by the debtor shall be valid as against such transfer.

Sec. 38 of the Insurance Act which governs all assignments of life insurance policies on or after 1—7—1939 lays down as follows :

(1) A transfer or assignment of a policy of life insurance, with or without consideration, may be made only by an endorsement on the policy itself, or by a separate instrument setting forth the fact of transfer or assignment signed by the transferor or his agent, and attested by atleast one witness.

(2) The transfer shall be complete and effectual upon the execution of such endorsement or instrument duly attested. Except where the transfer or assignment is in favour of the insurer it shall not be operative as against the insurer, and shall not confer upon the transferee or assignee any right to sue for the amount of such policy or the monies secured thereby, until a notice in writing of the transfer or assignment together with the said endorsement or instrument itself or a copy of the same certified to be correct, by both the transferor and the transferee, has been delivered to the insurer at his principal place of business.

(3) The date on which the notice referred to above is delivered to the insurer shall regulate the priority of all claims under a transfer or assignment as between the persons interested in the policy ; and where there is more than one instrument of transfer or assignment, the priority of the claims under such instruments shall be governed by the order in which the said notices are delivered.

(4) On the receipt of the notice referred to above, the insurer shall record the fact of such transfer or assignment together with

the date thereof, and the name of the transferee or the assignee. The insurer shall on the request of the person who gave the notice or the transferee or assignee grant a written acknowledgment of the receipt of such notice on payment of a fee not exceeding one rupee. Such acknowledgment is conclusive evidence against the insurer that he has received the said notice.

(5) From the date of the receipt of the notice referred to above, the insurer shall recognise the transferee or assignee (subject to the terms contained therein) as the only person entitled to benefit under the policy. The transferee or assignee shall be subject to all liabilities and equities to which the transferor or assignor was subject at the date of the transfer or assignment, and may institute any proceedings in relation to the policy without the consent of the transferor or assignor or making him a party to such proceedings.

(6) As already stated the rights and remedies of an assignee or transferee under a policy of life insurance effected prior to 1—7—1939 are not effected by this section. An assignment in favour of a person made with a condition that it shall not be operative or that the interest shall pass to some other person on the happening of a specified event during the life time of the person whose life is insured, and an assignment in favour of the survivor of a number of persons, are valid notwithstanding any law or custom to the contrary.

### Nomination by policy holder

Secs. 39 and 94 of the Insurance Act of 1938 have resolved many of the controversies in India relating to the nomination of a policy of life assurance by laying down the following rules.

(1) Sec. 94 lays down that no nomination shall be valid if the person nominated is not the husband, wife, father, mother, child, grand-child, brother, sister, nephew or niece of the holder of the policy.

(2) The holder of the policy of life insurance on his own life, not being an absolute assignee of the benefits under the policy may, when effecting the policy, or at any time before the policy matures for payment, nominate the person or persons to whom the money secured by the policy shall be paid in the event of his death.

(3) Such nomination unless incorporated in the text of the policy itself, should be made by an endorsement on the policy communicated to the insurer, which should be registered by him in the records relating to the policy.

(4) Any such nomination may at any time before the policy matures for payment, be cancelled, or changed, by an endorsement or a further endorsement, or will, as the case may be. Unless notice in writing of such cancellation or change has been delivered to the insurer he shall not be liable for any claim under the policy made bona fide by him to a nominee registered in the records, or mentioned in the text of the policy.

(5) A policy holder is entitled to receive from the insurer an acknowledgment of having registered a nomination, or a cancellation, or change thereof and the insurer is entitled to charge a fee not exceeding one rupee for registering such cancellation or change.

(6) A transfer or assignment of a policy made in accordance with Sec. 38 (supra) shall automatically cancel a nomination.

(7) Where the policy matures for payment during the life time of the person whose life is insured, or where the nominee dies before the policy matures for payment, the amount secured by the policy shall be payable to the policy holder, or his heirs, or legal representatives as the case may be.

(8) Where the nominee survives the person whose life is insured, the amount secured by the policy shall be payable to the nominee.

(9) The foregoing provisions shall not apply to any policy of life insurance to which Sec. 6 of the Married Women's Policy Act 1874 applies.

#### **Married Women's Property Act**

Sec. 6 of the Married Women's Property Act, III of 1874, which is made applicable to any policy of life insurance effected by any Hindu, Muhammadan, Sikh or Jain in Madras after the 31st day of December 1913, or in any other part of British India after the 1st day of April 1923, enacts that a policy of insurance effected by any married man on his own life, and expressed on the face of it to be for the benefit of his wife, or of his wife and children, or any of them, shall enure and be deemed to be a trust for the benefit of his wife, or of his wife and children, or any of them, according to the interest so expressed, and shall not, so long

as any object of the trust remains, be subject to the control of the husband, or his creditors, or form part of his estate. Unless special trustees are duly appointed to receive and hold the monies under the policy of insurance to which Sec. 6 applies, they shall be paid to the Official Trustee of the Province in which the office of the insurer is situate, and it shall be received and held by him upon the trust expressed in the policy or such of them as are then existing.

*Note:—*In order to constitute a trust for the benefit of the wife within the meaning of this section, it is not necessary that the words 'for the benefit of the wife' or other equivalent words should appear in the policy. If on a reading of the words used in the policy it appears that the assured intended in the event of his death that the policy should enure for the benefit of his wife, then the policy may be deemed to be for her benefit. *Abhiramavalli Ammal v. The Official Trustee of Madras*, 55 Mad. 171. The Court can also look into the proposal for the said purpose, when it is made a part of the policy. *Krishnan Chettiar v. Velayee Ammal*, I. L. R. 1938 Mad. 909 (F.B.) In this case it was held that where the money under a policy of insurance was made payable to 'self or wife' a trust was created in favour of the wife of the assured, in the event of the assured dying before the policy matured. It was also held that there could be a contingent trust under Sec. 6 of the Act. It should therefore be noted that in cases to which Sec. 6 of the Married Women's Property Act applies a nomination in favour of the wife or children creates a trust, and will not simply have the effect of an ordinary nomination, and in those cases it is not open to a creditor of the assured to treat the policy as the property of the assured, nor can he assign the policy so as to defeat the rights of the persons in whose favour the trust is created. It has been held in *Krishnamurthy v. Anjayya*, 71 M.L.J. 39 that the words "for the maintenance of the family" appearing in the application form as the object of the policy, did not create a trust in favour of the wife or children of the assured, and that the policy amount was liable to be attached for the debts of the policy holder after his death.

### Fire Insurance

A policy of fire insurance as its name indicates is intended to protect the assured against loss caused by fire. The subject

matter of a contract of fire insurance may be any property in the widest sense of the term. It may be buildings, ship, or merchandise, or articles of apparel, or documents, or even intangible property like rents and profits due from any property. Fire policies cover loss by fire. Ignition is necessary to fire; heating unaccompanied by ignition is not fire. The cause of fire is not material unless, it is the deliberate act of the assured himself, or of some one acting with his knowledge or consent. Loss by fire which is caused by the negligence of the assured may be recovered. In *Harris v. Poland*, (1941) 1 K. B. 462 the assured hid her jewellery under the coal in the grating near the fire place. Having forgotten that fact, she lit the fire and the jewellery was damaged. Held she could recover under the fire policy. In ordinary practice the protection of the policy extends to losses caused by lightning, and certain kinds of explosion. By a contract of fire insurance the insurer in consideration of a certain premium undertakes to indemnify the assured against damage to his property by fire, during a limited period of time, usually a year. The contract is generally in the form of a policy but may equally be well effected by a slip, or cover note, or even orally.

A contract of fire insurance, as already noticed, differs from a contract of life assurance in that the former is a contract of indemnity while the latter is not. The principles which have been noted (*supra*) under the head of *General Principles Applicable to Non-Marine Insurance viz.*, average clause, indemnity, ubberri-mae fidei, subrogation, and contribution apply in cases of fire insurance and hence they are not repeated.

#### Insurable interest

In the case of fire insurance, as in other contracts of insurance, the insured must have an insurable interest in the subject of the insurance. Otherwise the contract will be a mere wager and will be void. An insurable interest in property at risk under a fire policy may arise from the natural relationship between the assured and that property, or by operation of law. In England there is a statutory obligation in certain cases to insure against fire. In India also certain persons may be required under a statute to insure against fire, if so directed, e.g., under S. 17 of the Trustees and Mortgagees Powers Act 28 of 1866, a receiver is required, if so directed in writing by the person entitled to money

secured by charge upon the property, to insure and keep insured from loss or damage by fire the whole or any part of the property which is in its nature insurable. Apart from such statutory provisions, an obligation to insure against fire may be created by will or contract. It may be noted that it is not only the legal but also the beneficial owner of the property that possesses an assurable interest therein. Thus (1) tenants who are liable to pay rent after fire, (2) carriers, in-keepers, and wharfin-gers, for goods entrusted to them, (3) mortgagees, (4) Official Assignees and Official Recivers, (5) Executors and Trustees, are all held to be persons entitled to insure any property which is insurable and which may be in their charge. Whether a failure to insure property against fire would itself amount to negligence on the part of the person in possession of it, whether as bailee, trustee, executor, or Official Assignee, etc., depends upon the circumstances of each case. It is not necessary that insurable interest should subsist at the time of insurance. It is sufficient as in the case of marine insurance, if it exists at the time of the loss.

### Meaning of 'cover'

In the law relating to fire insurance the word 'cover' has more than one meaning. Sometimes it is said that the assured is 'covered' between one date and another. Sometimes it is said a building or a chattel is 'covered by the insurance effected'. Strictly speaking what is covered by the insurance is the risk to which the property, wherein the assured has an interest, is exposed. The interest in the case of fire insurance is that the property concerned, shall not be destroyed or damaged by fire. There will not be any difficulty if this distinction is remembered viz., that the *subject* of insurance means 'the peril insured against' and the *subject-matter* of insurance means 'the property exposed to risk.'

*What is the risk insured* :—It may be noted that the risk ordinarily insured against under the words 'by Fire' is not confined to damage to property which actually catches fire, but includes loss occasioned even incidentally e.g., by scorching or melting etc. Further it includes all loss caused by fire, irrespective of the place where the fire originated. As a general rule it is immaterial how a fire originates. In most of the modern policies several perils are excepted. e.g., the insurance is not made



to cover ; (i) loss by theft during or after occurrence of a fire ; (ii) loss or damage to property occasioned by its own fermentation, natural heating, or spontaneous combustion etc. ; (iii) loss or damage occasioned by or through or in consequence of (a) the burning of property by an order of any public authority, or (b) subterranean fire. Further events in the nature of Acts of God and various forms of vis major e.g., earth-quake, volcanic eruption, cyclone, or other convulsions of nature, war, invasion, act of a foreign enemy, mutiny, rebellion, revolution, military, naval or usurped power, or martial law etc., resulting in loss or damage to the property insured are generally excepted in modern policies.

### Assignment

Sec. 135 of the T. P. Act lays down that every assignee by endorsement or otherwise of a policy of marine insurance, or of a policy of insurance against fire, in whom the property in the subject insured shall be absolutely vested at the date of assignment, shall have transferred and vested in him all rights of suit, as if the contract contained in the policy had been made with himself.

Thus according to this section the mere fact that the property insured against fire is transferred does not entitle the transferee to claim the benefit of the insurance, unless the policy is also assigned in his favour, whether by an endorsement or by other writing. The section makes it clear that once there is such an assignment of the policy, and the assignee is the person in whom the property in the subject insured is vested, he shall have all rights of suit as if the contract contained in the policy had been made with himself. Sec. 49 of the T. P. Act lays down that where immoveable property is transferred for consideration and such property or any part thereof is at the date of the transfer insured against loss or damage by fire, the transferee in case of such loss or damage, may, in the absence of the contrary, require any money which the transferor actually receives under the policy, or so much thereof as may be necessary to be applied in re-instating the property.

### Marine Insurance

*Preliminary* :—The law relating to marine insurance has been codified in England by the Marine Insurance Act 1906 which came into force on 1st January 1907. In India notwithstanding the very extensive coast line and a number of important harbours the subject of marine insurance has received very little

attention of the mercantile community and consequently the law relating to it has not developed to any appreciable extent. We have already noticed that the Indian Insurance Act of 1938, has not dealt with the substantive law relating to insurance, and the law relating to marine insurance in India therefore remains un-confined, and has to be gathered from judicial decisions on the subject. It may be remembered that in the absence of any statutory provision or custom of native merchants the Indian Courts would apply the principles embodied in the English Code which are based upon the judicial decisions in that country.

*Definition* :—A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed against marine losses, that is to say losses incident to marine adventure. The instrument in which a contract of marine insurance is generally embodied is called a policy. The insurer is commonly called the under-writer because he subscribes the policy. The thing or property insured is called the subject matter of insurance, and the interest of the assured in such subject matter is insurable interest. The consideration for which the insurer undertakes to indemnify the assured is called the premium. That which is insured against is the loss arising from maritime perils and casualties and they are called the perils insured against, or the losses covered by the policy.

### Attachment of Policies

When the liability of the under-writer commences under the contract, the policy is said to attach, or in other words the risk is said to attach, or begin to run from that time.

### Kinds of marine policies

*Valued policy*: It is one which specifies the agreed value of the subject matter insured. In the absence of fraud this value is conclusive between the insurer and the assured, whether the loss be partial or total. But it is not conclusive in determining whether there has been a constructive loss. Here overvaluation is not fraudulent unless it be of very gross nature.

*Unvalued or open policy:* It is one which does not specify the value of the subject matter but leaves it to be subsequently ascertained, subject to the limit of the sum assured.

*Voyage Policy:* It is a contract to insure the subject matter "at and from" or from one place to another.

*Time policy:* It is a contract to insure the subject matter for a definite period of time.

*Mixed policy:* It is a contract to insure the subject matter for a certain time as well as for certain voyage i.e., it is a combination of the voyage as well as time policies.

*Floating policy:* It is one which describes the insurance in general terms, and leaves the particulars like the name of the ship etc. to be defined by subsequent declaration.

### Subject matter of Insurance

The properties in respect of which policies of marine insurance are taken, are those which are exposed to the perils of the sea, e.g., ships, cargo, freight or profits. But every lawful marine adventure may be the subject of a contract of marine insurance. Marine adventure includes : (i) ship, goods, or other moveables (any tangible moveable property other than the ship, and including money, valuable securities, and other documents) which are exposed to maritime perils; (ii) The earning or acquisition of any freight, commission, or other pecuniary profit, or security for any advances, which is endangered by the exposure of insurable property to maritime perils; (iii) liability to a third party which may be incurred by the owner of, or a person interested in, insurable property by reason of maritime perils.

'*Maritime perils*' means perils consequent on, or incidental to the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints, and the detainments of princess and peoples, jettisons, barratry, and any other perils, either of the like kind or which may be designated by a policy.

*Jettison* : means throwing overboard of tackle or cargo in order to lighten the ship bona fide and in an emergency.

*Barratry* : includes every wrongful act wrongfully committed by the master or crew to the prejudice of the owner or charterer e. g., setting fire to a ship or scuttling it.

Thus it has been held that a carrier of goods by sea, a charterer of a vessel, and a company that lays down an electric cable, are all engaged in marine adventures. It may be that a contract of marine insurance may by its terms or mercantile usages be extended to protect the assured against losses on inland waters, or any risk on land incidental to a sea voyage.

### Insurable Interest

When the assured has no insurable interest a contract of marine insurance amounts to a wagering contract and is void. A person has an insurable interest when he is interested in the marine adventure, and in particular where he stands in any legal or equitable relation to the adventure, or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, damage, or detention, or may incur liability in respect thereof. The assured must have insurable interest at the time of the loss although he need not have it when the insurance is effected. If the goods are insured "lost or not lost" such interest in them may be acquired even after the loss has actually occurred, unless at the time of effecting the insurance the assured was aware of the loss and the insurer was not. It may be noted that even defeasible and contingent interest as well as partial interest of any nature are insurable.

The following are persons having insurable interest :

- (i) ship owners and owners of goods to the extent of the value of their interest ;
- (ii) a mortgagee to the extent of the sum due to him ;
- (iii) a mortgagor to the full value of the property ;
- (iv) the lender of money on *bottomry*, or *respondentia*, to the extent of the loan. *Bottomry* is a pledge of the ship and freight to secure a loan in order to enable the ship to continue her voyage. *Respondentia* is a pledge of the cargo only and not of the ship.
- (v) an insurer may re-insure to the extent of his liability.
- (vi) the master and crew may insure their wages.

### Disclosure and Representation

A contract of marine insurance also requires utmost good faith and if it be not observed by either party, the contract becomes voidable. It is the duty of the assured to communicate to the insurer every circumstance known to him or which in the ordinary course of business, he ought to know, which is material to the risk, i.e., every circumstance which would influence a prudent insurer in fixing the premium or determining whether he will take the risk. This obligation to disclose extends to communications made to or information received by the assured. The following are facts which should be communicated: (i) news tending to show that the vessel is lost; (ii) that it is damaged; (iii) that the vessel is over due; (iv) nationality of the assured at a time when it is important. It was held that the following facts need not be communicated to the insurer: (i) those diminishing the risk; (ii) speculations as to war; (iii) tempest; (iv) general trade customs.

Where the insurance is effected by an agent, he is similarly bound to disclose to the insurer every fact which the assured himself ought to disclose, and also every material fact known to the agent, whether actually known or which he ought to know in the ordinary course of business, or which ought to have been communicated to him.

### The Policy

A contract of marine insurance is not valid unless it is contained in a policy signed by, or on behalf of the insurer, and sealed, if the insurer happens to be a corporation. It is usual to draw up a memorandum of the terms which is initialled by the under-writers, before the execution of a formal policy, and that memorandum is called "*the slip*". The slip can be looked at by a Court only for collateral purposes but it cannot be sued upon, because a suit can be brought only on the foot of the policy. A policy of marine insurance contains the following particulars; (i) the name of the assured or of some person who effects the policy on his behalf; (ii) the subject matter insured and the risk insured against, which should be described with reasonable certainty; (iii) the voyage, or period of time, or both as the case

may be ; (iv) the sum or sums insured; (v) the name or names or the insurers.

The policy may be in print, or writing or partly written, and partly printed. The Marine Insurance Act of 1906 sets out in the schedule the form known as Lloyd's S. G. Policy' which is the policy generally adopted.

### Re-insurance

Re-insurance occurs when an insurer insures the risk undertaken by him with another insurer. The law applicable to it is the same as that which governs the original insurance. The contract of re-insurance is also a contract of indemnity, and the insurer cannot recover anything more than what he paid to the assured. A re-insurer however need not give notice of abandonment. The doctrine of subrogation applies to re-insurance, and the re-insurer is entitled to his proper proportion of any money which has been or could be recovered by enforcing a right that could diminish the loss of the original insurer.

### Double Insurance

A double insurance occurs when the assured effects two or more policies on the same interest and adventure. If the sums insured by two or more policies exceeds the indemnity allowed by the Act, the assured is said to be over insured by double insurance. In such a case the assured, unless the policy otherwise provides, may claim payment from the insurers in such order as he may think fit, provided that he is not entitled to receive any sum in excess of the indemnity allowed by the Act. Thus if a merchant whose whole interest is of the value of £. 6,000, first effects a policy on this interest at Liverpool for £. 4,000, and then another policy on the same interest at London for £. 6,000, he can recover the whole amount of £. 6,000 on the London Policy. Where the policy under which the assured claims is a valued policy, the assured must give credit as against the valuation for any sum received by him under any other policy, without regard to the actual value of the subject matter insured, and where the policy is an unvalued policy he must give credit as against the full insurable value for any sum received by him under any other policy. Where the assured is over insured by double insurance,

each insurer is bound as between himself and other insurers to contribute rateably to the loss in proportion to the amount for which he is liable under his contract, and if any insurer pays more than his proportion of the loss, he is entitled to maintain an action for contribution against the other insurer, and to the like remedies as a surety who has paid more than his proportion of the debt. Where the assured receives any sum in excess of the indemnity allowed by the Act, he is deemed to hold such sum in trust for the insurers according to their right of contribution among themselves.

### Warranties

A warranty is either an undertaking by the assured that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or it is a statement which affirms or negatives the existence of a particular state of facts. Thus a warranty may be an undertaking that the ship insured sailed on a certain date, or shall sail on or before a given date, or that she will depart with convoy. A warranty must be exactly complied with whether it be material to the risk or not. If it is not complied with, the insurer is, subject to any express provision in the policy, discharged from liability without prejudice to any liability incurred by him before that date. Once a warranty is broken the assured cannot contend that the breach has been remedied and the warranty complied with before the loss, because as soon as the breach occurs the underwriter is *ipso-facto* discharged from liability. A warranty may be *express* (i.e. included in or written upon the policy, or in some document incorporated therein by reference) or *implied* i.e., a condition implied by law e.g., in the case of a voyage policy that the ship is seaworthy at the commencement of a voyage, or that she will not deviate from the usual course of voyage. An express warranty is an absolute condition precedent, and its breach is not excused except when the state of things contemplated by the warranty ceases, or when the warranty, or compliance with the warranty is rendered unlawful by any subsequent law. It may therefore be noted that the word warranty in marine insurance has a meaning different from that in the law relating to sale of goods.

### Alteration of voyage

In a voyage policy if the voyage is altered, the insurer is discharged from liability. If a ship is said to be at a particular place at the time of the contract, it is not necessary that it should be at that particular place. But the voyage must be commenced within a reasonable time. If the ship does not sail from the port of departure stated in the policy, or does not reach the destination so specified, or does not prosecute the voyage with reasonable despatch, in all these cases the insurer will not be liable on the policy. Once the ship deviates from the voyage contemplated by the policy, the insurer is discharged from liability from the time of deviation, notwithstanding that the ship may have regained her route before any loss occurred. If the policy specifies a number of ports of discharge she must proceed to such of them as she goes to in the order designated by the policy. If she fails to do so there is a deviation. Deviation is however excused in the following cases : (i) if specially authorised by the policy ; (ii) if caused by circumstances beyond the control of the master or of his employer , (iii) if reasonably necessary to comply with a warranty ; (iv) to ensure the safety of the ship ; (v) to save human life ; (vi) to obtain medical help for any person on board ; (vii) if caused by barratrous conduct of the master or crew, if barratry be one of the perils insured against.

### Assignment of Marine Policy

A marine policy is assignable by endorsement, and the assignee can sue on it in his own name subject to any defence which would have been available against the person who affected the policy. The assignment may be made either before or after loss. But an assured who has parted with, or lost his interest in the subject matter assured, cannot assign. Sec. 135 of the Transfer of Property Act lays down that every assignee by endorsement or other writing of a policy of marine insurance, in whom the property in the subject insured shall be absolutely vested at the date of the assignment, shall have transferred and vested in him all rights of suit, as if the contract contained in the policy had been made with himself.

The section therefore makes it clear that even though the property which has been insured is transferred by the assured, the



transferee cannot sue the under-writer unless there has been an assignment of the policy in favour of the transferee.

### The Premium

An insurer is not bound to issue a policy unless the premium is paid. Where the insurance is effected through a broker he will be liable to the insurer for its payment. The broker will however have a lien on the policy for the premium paid by him and his charges.

*Return of Premium:*—The premium or a part of it has to be returned: (i) if the policy is void, or avoided by the insurer from the commencement of the risk; (ii) if the subject matter insured or a definite portion of it is never subjected to risk; (iii) if the assured had no insurable interest at any time during the currency of the risk, and the policy was not effected by way of a wagering contract. When the assured over insures on an unvalued policy, a proportionate part of the premium is returnable. Where he over insures by double insurance, a proportionate part of the several premiums is returnable, except when the double insurance is effected knowingly by the assured. Where the policies have been effected at different times, no premium is returnable in respect of any earlier policy which has borne the entire risk, or on which a claim has been paid in respect of the full sum insured.

### Losses

Except where otherwise agreed, the insurer is liable for any loss proximately caused by a peril insured against, even though the loss would not have occurred but for the negligence or misconduct of the master or crew. *Andersen v. Marten* (1908) A. C. 334. The rule that the loss must be traced to a proximate cause is rigorously applied in insurance cases. The cause which is truly proximate is that which is proximate in efficiency.

A loss may be either *total* or *partial*. Any loss other than a total loss is a partial loss. A total loss may be either an *actual total loss* or a *constructive total loss*. In the case of an actual total loss, also called *absolute total loss*, the assured is entitled to recover from the under-writer the whole amount subscribed by him without giving any notice of abandonment. But in the case of constructive total loss the assured is at liberty to elect whether to treat the loss as a total loss or a partial loss, and therefore

cannot recover for a total loss, unless he has given due notice of abandonment.

An actual total loss occurs : (i) when the subject matter is actually destroyed or irreparably damaged; or (ii) where the assured is irretrievably deprived of it ; or (iii) when goods are so damaged as to have ceased to exist in such condition or form as to answer the denomination under which they were insured, or when lost to the owner by an adverse valid decree of a competent Court in consequence of a peril insured against. Possession of the goods restored after the action is brought, does not dis-entitle the owners to recover as for a total loss.

A constructive total loss occurs where the subject matter insured is reasonably abandoned, because its actual total loss appears to be unavoidable, or because the expenditure to prevent an actual loss would be greater than the value of the subject matter when saved. Thus where a vessel had sunk in deep water and could not be raised without incurring an expense greater than her value, it was held that it was a case of constructive total loss. *Kemp v. Halliday* (1866) L. R. 1 Q. B. 520. Similarly where the ship has been so damaged that the cost of repair would exceed her value when repaired, it will be a case of constructive total loss. As already stated, in the case of a constructive total loss the assured can abandon the subject matter to the insurer, and treat the loss as an actual total loss. The notice of abandonment may be written or oral, so long as it clearly indicates that the assured has unconditionally abandoned the subject matter of insurance to the insurer. The notice must be given within a reasonable time, and if not given, the loss will be considered as partial. On abandonment, the insurer becomes the owner of the subject matter insured ; and consequently he is entitled to any freight earned subsequent to the accident causing the loss.

### General Average

A *general average* is a loss caused by, or directly consequential on a *general average act*. It includes a general average expenditure as well as a general average sacrifice. There is a general average act where any extraordinary sacrifice or expenditure is voluntarily and reasonably made or incurred in time of

peril for the purpose of preserving the property imperilled in the common adventure. Where there is general average loss the party on whom it falls (the insurer) is entitled, subject to the conditions imposed by maritime law, to a rateable contribution from the other parties interested, and such contribution is called a *general average contribution*. If the general average loss has been in connection with peril insured against, the assured may recover the whole amount from the insurer without having recourse to the other parties liable to contribute.

### Particular Average

Particular average loss, is a partial loss of the subject matter insured caused by a peril insured against, which is not a general average loss. It gives no right of contribution from the other parties interested in the adventure. Such a loss can be recovered from the insurers if it is caused in connection with a peril insured against.

### Adjustment of Losses

The settlement between the assured and the insurer is styled the *adjustment*, and is usually settled on behalf of the parties by their brokers. Marine insurance being essentially a contract of indemnity, the assured can only recover the loss he actually sustains. In the case of a total loss, if the policy is a valued policy, the amount payable by the insurer is what is fixed in the policy. If it is unvalued the amount payable is the full insurable value of the ship at the commencement of the risk, which includes out fit, stores, provisions, money advance for seamen's wages, together with the cost of insurance. In the case of a steamer, ship includes machinery, boilers, coals etc.

In the case of partial loss to the ship, the insurers in the absence of a provision to the contrary are liable to pay the following : (i) where it has been repaired, the cost of the repairs, less customary deductions which are usually  $\frac{1}{3}$  of the cost of new material replacing the old ; (ii) where the ship has been partially repaired the cost of repairs as stated above, and the amount of depreciation arising from the unrepaired damage; (iii) where the damage has not been repaired, the amount of depreciation from the unrepaired damage.

*In the case of loss of goods :—*

In the case of a total loss of goods : (i) if the policy is unvalued, the assured may recover the insurable value of the part lost i.e., the prime cost of the goods, plus expenses of shipping and insurance charges ; (ii) if the policy is valued, the insurer has to pay the amount agreed. In the case of partial loss of goods he has to pay ; (i) if the policy is valued, such proportion of the fixed value, as the value of the lost goods bears to the whole value of the insured goods ; (ii) if the policy is unvalued, the insurable value of the part lost ; (iii) if the goods have been damaged, such proportion of the fixed value (in the case of valued policy), or of the insurable value (in the case of an unvalued policy), as the difference between the gross sound and damaged values at the place of arrival bears to the gross sound value.

**Successive Losses**

Although the total amount of successive losses exceeds the amount insured, the insurer will be liable. But where the partial loss which has not been adjusted is followed by a total loss, the assured can only recover for the total loss. It is the duty of the assured to take all reasonable steps to prevent or minimise a loss. In order that his rights to recover the amounts expended for preserving the property may not be prejudiced, the policies contain what is called "*a suing and labouring clause*" which enables the assured to recover from the insurer all expenses properly incurred pursuant to the clause, even though the insurer has paid for a total loss.

**Subrogation**

Where the insurer pays for a total loss—either of the whole, or in the case of goods, of any apportionable part—he becomes entitled to the interest of the assured in the subject matter insured, and is subrogated to all his rights and remedies therein. Where an insurer pays for a partial loss, he acquires no title to the subject matter insured or such part of it as may remain, but he is subrogated to the assured's rights and remedies therein, in so far as the assured has been indemnified by payment. The result is that in the former case he becomes entitled to whatever remains of the subject matter insured, while in both cases he is

entitled to bring an action in the name of the assured against any person responsible for the loss.

### Mutual Insurance

It is the name given where two or more persons agree to insure each other against marine losses. The rights and duties of the parties *inter se* depend on the agreement between them and the general principles of marine insurance will be modified to that extent. In these cases no premium is generally payable, but each party agrees to contribute to a loss in a certain proportion.

### Motor Vehicle Insurance (Third party risk)

As already noticed a person may effect what is called liability insurance, in which the event results in liability. Thus motor vehicle insurance, employer's liability insurance and all other insurances against liability are examples of this kind of insurance.

The Motor Vehicles Act of 1939 (Chapter VIII) makes insurance of third party risks compulsory. It has largely reproduced the provisions of the English Law embodied in the Road Traffic Acts of 1930 and 1934, the Road Transport Lighting Act of 1937, and the Third parties (rights against insurance) Act of 1930. Consequently the decisions based on the provisions of the English statutes can be referred to with great advantage in our country. According to Sec. 94 of the Motor Vehicles Act 1939, which came into force on 1-7-46 no motor vehicle can, from that date, be used in a public place, unless there is in force an insurance policy in respect of such vehicle. The Motor Vehicles Act of 1939 is applicable to the whole of British India.

### Nature of motor vehicle insurance

A policy of motor vehicle insurance is in the ordinary course a combined insurance. It insures the vehicle and its accessories against loss or damage, and it also insures against liability to third parties. It is a contract of indemnity. We are concerned with motor vehicle insurance against liability to third parties. The object of such a policy is to protect the assured against his liability to third parties arising out of accidents caused by the use of a motor vehicle on the road. The liability may be for

death, or bodily injury, or for damage to property. The legal liability for accidents on the road, resulting from the use of motor vehicle, is in the ordinary course founded on negligence. The policy is consequently a contract of indemnity against the consequences of negligence, whether it is negligence of the assured himself, or of his servant. This kind of policy is not opposed to public policy, and is a valid contract of insurance, although the result of negligence may be the death of a third party. It may be noted that the policy confers no indemnity against consequences resulting from intentional acts. At the same time the degree of negligence is immaterial. The liability arises in every case in which the motor vehicle is the efficient cause of an accident to a third party, even if the vehicle itself is not damaged on account of the accident. But this rule is subject to a term in the insurance policy to the contrary.

### Extension of protection

The insurance against third party risks is usually identified with the particular motor vehicle described in the policy. Sometimes the policy may provide that so long as the assured owns the vehicle which is insured, he is covered against any liability which he may incur to third parties while using that vehicle on the road. But even in the case of such a policy, the moment he parts with the ownership in the insured vehicle his protection also comes to an end. Sometimes the policy contains a provision protecting even persons other than the assured, e.g., the relatives, or friends of the assured, or other persons driving the vehicle with his permission, against any liability which they may incur to third parties while using the insured vehicle, but such protection is usually limited to persons who are not protected against liability by any other insurance. Any person coming within the terms of the policy is entitled to enforce it in respect of any damages for which he may have been liable on account of an accident occurring while driving the insured car. The Act makes it an offence punishable with imprisonment which may extend to 3 months, with or without fine which may extend to Rs. 500 for any person, other than a mere passenger, to use, or to cause, or allow any other person to use a motor vehicle in any public place, unless in relation to the use of that vehicle by that

or some other person, as the case may be, there is in force a policy of insurance against third party risks, and which otherwise complies with the requirements of the chapter. A mere paid servant using a vehicle which is not so insured is not however punishable, unless he knows or has reason to believe that there is no such policy in force. The Act also requires that the policy must be one issued by an authorised insurer, and which insures the person or classes of persons specified in the policy to the extent specified in it against third party liability arising out of the use of the vehicle in a public place.

### **Vehicleless which need not be insured**

The provisions regarding compulsory insurance against third party risks are not made applicable to vehicles owned by the Central or a Provincial Government, or a local authority exempted by a notification, or a State owned Railway when the vehicle is driven by a Government servant in the course of his employment.

### **Powers of Provincial Government**

Considerable powers are given to Provincial Governments to make rules compelling owners of motor vehicles to insure against third party risks, and to appoint a person or body of persons, to investigate and report on motor accidents involving death or bodily injury. A Provincial Government may prescribe that a policy, in order to comply with the Chapter, must expressly cover any liability arising under the Workmen's Compensation Act 1923, in respect of the death of, or bodily injury to, any paid servant when engaged in driving, or otherwise being in attendance on, or being carried in a motor vehicle.

### **Third parties' rights against insurers**

The delivery of a certificate of insurance to the assured imposes, upon the insurers the duty of satisfying by payment to the third party any judgment subsequently obtained by him against the assured. The effect of this and other provisions in the Act is to compel the insurer to satisfy those claims, notwithstanding that he may be entitled to avoid or cancel the policy, or

may in fact have already done so. It may be noted that the rights which are available to an insurer under the English Road Traffic Act of 1934 are not made available to insurers by the Indian Act. Sec. 101 enacts that the insolvency of an assured is not to effect his liabilities in respect of claims by third parties under the Act. Further such third parties are given the right to sue the insurer, where the assured has become insolvent or entered into an arrangement with his creditors. A similar right may be exercised where the company which insures goes into liquidation, but not if the winding up be voluntary and merely for the purpose of reconstruction or amalgamation.

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## CHAPTER XXV

### SECURITIES

This chapter deals under different heads with rights which are somewhat similar, in that in each case a person acquires certain rights in the property of another, by way of security, for the liability that has been contracted by that party. Hence they are generally called securities. Securities may be any one of the following: (1) Pawn or Pledge (2) Mortgage (3) Lien.

**Pawn or Pledge :—**In this case the possession of property is delivered to the creditor (pawnee), but the ownership remains with the debtor (the pawnor), and the law relating to this subject has been already considered supra. (Chapter XVI Bailments.)

**Mortgage :—**We are here concerned with mortgage of goods or moveable property, also called personal property. In the case of a mortgage, the property in the thing mortgaged is conveyed to the mortgagee conditionally, while the possession until default in payment of the debt, generally remains with the owner (mortgagor). In England there are Acts called the Bills of Sale Acts 1878 and 1882, which apply in most cases of mortgages of personal property. The object of the Act of 1878 is to prevent false credit being given to persons who are in apparent possessions of goods, which in truth belong to others. The object of the Act of 1882 is to protect impecunious persons, who, it was believed, were often induced to sign complicated documents of charge, which they did not understand. Therefore the Act of 1882 lays down that bills of sale given by way of security for money, are totally invalid if they are not in the prescribed form. A bill of sale is defined in both the Acts as including; (1) bills of sale strictly so called i.e., assignments of personal chattels giving a title without delivery, (2) assignments, (3) transfers, (4) declaration of trust without transfer, (5) inventories of goods with receipt thereto attached, or receipts for purchase money of goods and assurances of personal chattels, (6) licenses to take possession of chattels as security for any debt, and also any agreement whether intended or not to be followed by the execution of any

other instrument, by which a right in equity to any personal chattels, or to any charge or security thereon shall be conferred. But the phrase bill of sale does not include : (1) assignments for the benefit of creditors, (2) marriage settlements, (3) transfer of ships or shares therein, (4) transfer of goods in the ordinary course of trade, (5) bills of lading or other documents of title (6) assignment of fixtures, unless separately assigned. Thus it may be noted that the Bills of Sale Acts apply to many cases of mortgages of personal property.

A mortgage of goods is in form and in strict law a conditional sale. But from the earliest times equity has regarded it as nothing more than a security. It therefore does not give complete ownership to the mortgagee over the goods sold, which is an essential part of a contract of sale, and hence a mortgage of goods is specifically excluded from the operation of the Indian Sale of Goods Act, by Sec. 66 (3) of that Act.

The Transfer of Property Act refers to mortgages of immoveable property, and the Indian Contract Act refers to pledges, of moveable property. Neither Act deals with mortgages of moveable property, but it is settled law that hypothecation or mortgage of moveable property though not accompanied by delivery of possession is valid in Indian Law. 8 Madras 104 (F. B.)

As a transfer of moveable property is not complete without delivery of possession, a mortgage of moveables has been described as creating an equitable charge. For this reason a mortgage of moveables is liable to be defeated if the mortgagor in possession sells the goods to a *bona fide* purchaser without notice. The reason for this rule is that when goods are left in the possession of a mortgagor a wide door is left open for fraud, and when the equities between the innocent purchaser and the mortgagee have to be weighed, preference must be given to the purchaser, because the mortgagee has by his omission to secure possession of the goods facilitated the commission of the fraud. *Sreeram v. Bammireddi* 42 Mad. 59. In England, as already noticed, the mortgages of personal chattels are generally governed by the Bills of Sale Acts of 1878 and 1882, as subsequently amended, which contain stringent provisions designed to protect creditors and prevent fraud. In India there are no corresponding

Acts and therefore no particular formalities are necessary for the creation of mortgage in respect of moveable property, and even an oral mortgage of goods is perfectly valid. A mortgage of moveables being an equitable charge, the provisions which apply to a simple mortgage shall so far as may be, apply to it e.g., sale of the security for realisation of the debt and enforcement of the personal covenant. But as stated above the rights of the mortgagee will be of no avail against *bona fide* purchasers for value without notice.

### Lien

A lien may be one of three kinds : (1) possessory, (2) maritime, (3) equitable.

*Possessory lien*:—A possessory lien is a right entitling a person having possession of the goods belonging to another to retain them until all claims against that other have been satisfied. A possessory lien may be : (1) a particular lien, or (2) a general lien. A general lien may arise by : (i) course of dealing, (ii) usage, or (iii) express agreement. This topic has been considered (*supra*) pages 119, 120, 136, 163. It may be noted that there is no general right of sale in the case of a lien, but it may be conferred by a statute or agreement.

A possessory lien is extinguished:

- (i) by loss of possession of goods :
- (ii) payment or tender of the amount due ;
- (iii) waiver ;
- (iv) taking a security in substitution for the lien.

*Maritime lien* :—A maritime lien is one which attaches to a thing in connection with liability incurred in relation to a maritime adventure. It specifically binds a ship, furniture, tackle, cargo, and freight, for payment of a claim founded upon the maritime law. It is different from a possessory lien, in that (i) it is not founded upon possession, but travels with it who ever might be in possession of it, and (ii) it is exercised by taking proceedings against the property itself e.g., by arresting the ship through the medium of the Admiralty Court. Persons who have maritime lien are : (i) salvor—on the property saved, (ii) the seamen for their wages, (iii) the master for wages

and disbursements, (iv) the holder of a bottomry bond for the amount of his bond, and (v) claimants in respect of damage caused, or collision due to the ship's negligence. A maritime lien attaches to the ship even though it is sold to a *bona fide* purchaser without notice of the lien, and the lien continues to exist until payment, or release, abandonment or destruction of the ship.

*Equitable lien* ;—An equitable lien is the right to have a specific portion of property allocated or charged for the payment of specific liability. It is different from a possessory lien in that it attaches independently of the possession of property. The right of a partner to have, on the dissolution of the firm, the firm's assets applied in payment of the firm's liabilities, (called partner's lien supra P. 190) is an example of an equitable lien. An equitable lien is binding on all persons who acquire the property which is subject to the lien with notice of it.

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## CHAPTER XXVI

### ARBITRATION

*History of the law:*—The law relating to arbitration in our country is to be found in the Arbitration Act X of 1940. Formerly the law was contained partly in the second schedule to the Code of Civil Procedure 1908, and the Indian Arbitration Act IX of 1899, but both of them were repealed by the Arbitration Act of 1940. This Act was passed with the object of consolidating and amending the law relating to arbitration, and it was made applicable to the whole of British India. It came into force on the 1st of July 1940. The second schedule to the Civil Procedure Code dealt with arbitration in the following cases: (i) where a suit had been instituted, and all the parties interested agreed to refer their differences in the suit to arbitration; (ii) where parties without having recourse to litigation agreed to refer their differences to arbitration, and they desired that the agreement of reference should have the sanction of a Court; and (iii) where the agreement of reference was made and the arbitration took place without the intervention of a Court, and its assistance was only sought in order to give effect to the award. Other cases of arbitration without the intervention of a Court were not dealt with by the Civil Procedure Code. The Arbitration Act of 1899, on the other hand, dealt with cases where an agreement of reference was made without the intervention of a Court, provided that the subject matter which was submitted to arbitration were such that, if it were the subject of a suit, it could, whether with or without leave, be instituted in a Presidency Town. Therefore it did not apply to cases of arbitration without the intervention of a Court in disputes, which could not be made the subject matter of a suit in a Presidency Town, but could only be brought in a Court in the mofussil. The result was, as rightly remarked by one author, that the law relating to arbitration in our country was frankly fragmentary, timorously tentative, and often bewildering. Further the law had made no appreciable progress as the Courts were only bothered about laying down mere rules of technical procedure.

The Arbitration Act of 1940 has done away with this unsatisfactory state of the law and has codified the principles of law applicable to all kinds of arbitration, whether made with or without the intervention of a Court, and whether the dispute was of a nature such as could be tried in a Presidency Town, or in the mofussil. It may be noted that the Act of 1940 is by no means an exhaustive code. It lays down only the broad principles of the law relating to arbitration, leaving it to the Courts to supply the details in consonance with the well established principles of law. The Act deals with the subject under three different headings:—

- (i) Arbitration without the intervention of a Court (Chapter II) ;
- (ii) Arbitration with the intervention of a Court where there is no suit pending (Chapter III) ; and
- (iii) Arbitration in suits (Chapter IV).

In Chapter V entitled '*General*' certain provisions applicable to all the three kinds of arbitration have been grouped together.

### Definitions

"*Arbitration agreement*" is a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not. This definition is the same as in the English Arbitration Act of 1934.

"*Award*" means arbitration award.

"*Court*" means a Civil Court having jurisdiction to decide the questions forming the subject matter of the reference, if the same had been the subject matter of a suit, but does not, except for the purpose of arbitration proceedings under Sec. 21, include a Small Cause Court. The effect of this definition is that a Small Cause Court has no jurisdiction over any arbitration proceedings, nor over any application arising thereout, except where the parties agree to refer to arbitration the differences between them in a suit pending before a Small Cause Court by an application under Sec. 21.

"*Reference*" means reference to arbitration.

*Note* :—The definition of "*arbitration agreement*" supra is in terms identical with the definition of the word "*submission*" in

the Indian Arbitration Act of 1899, as well as the English Arbitration Act of 1899. The said Acts did not however define an arbitration agreement. Originally "submission" was understood to mean an agreement to refer existing disputes to named arbitrators, while "agreement to refer" was understood to mean an agreement between parties that if any differences should arise, they should be referred to arbitration. But that distinction has now been done away with by the definition of "arbitration Agreement" in the Indian Act of 1940. An arbitration agreement gives the option to either party, in the event of a dispute, to take the necessary steps to get it decided by arbitration. It may be noted that an arbitration agreement cannot be oral, but should be in writing and should be duly stamped. If it is oral the machinery provided by the Arbitration Act will not be available to the parties. The arbitration agreement, may contain clauses which the parties think fit to insert, provided they are not opposed to public policy or the statute. The Act however provides that an arbitration agreement, unless a different intention is expressed therein, shall be deemed to include the provisions set out in the first schedule (considered *infra*) in so far as they are applicable to the reference (Sec. 3). Very often many commercial contracts e.g. partnership agreements, charter parties, and insurance policies provide that the disputes between the parties to those agreements may be referred to arbitration, and they may be construed as arbitration agreements. In such cases the Court, before which the proceedings in respect of the said disputes are brought, may stay the proceedings in order to enable the other party to take necessary steps for having the dispute settled by means of arbitration.

### Who may refer to Arbitration

*Minor.*—The capacity to make an arbitration agreement is co-extensive with capacity to contract. Therefore a person who is incapable of entering into a contract cannot be a party to an arbitration agreement. Thus a minor cannot according to Indian Law enter into arbitration agreement, and an award obtained in pursuance thereof is not binding on him, because a contract by a minor is absolutely void in our country. According to English Law a submission made by an infant cannot be

enforced against him during his minority, and may be avoided by him on his attaining majority. He cannot effectively ratify the submission except when it relates to the supply of necessities, or a contract plainly for his benefit, which is binding upon him, even during his minority.

A natural guardian may enter into an arbitration agreement on behalf of a minor, if it be proper, reasonable, and for the benefit of the minor. A *guardian ad litem* and a guardian appointed under the Guardian and Wards Act may refer to arbitration, provided the reference is for the benefit of the minor. A lunatic is in the same position as a minor in this regard.

*Insolvent* :—There is no objection to an insolvent or a bankrupt making a submission in respect of disputes to which he is a party, so as to bind his estate.

*Agent* :—An agent may be authorised to enter into an arbitration agreement on behalf of his principal. It has already been noted that in the absence of a usage, or a custom of trade to the contrary, a partner has no implied authority to submit a dispute relating to the business of the firm to arbitration.

*Corporations* .—A corporation whether sole or aggregate, can refer to arbitration. But in the case of the latter the submission must satisfy the statutory provisions in regard to the same.

*Companies* :—According to Sec. 152 of the Companies Act, a company may refer to arbitration any existing or future differences between itself and any other company or person by means of a written agreement in accordance with this Act.

*Trustees and Executors* :—They can also refer to arbitration.

### What can be referred to arbitration

To constitute a reference to arbitration, there should be some difference or dispute, either existing or prospective, between the parties, and in the case of an agreement to refer future disputes to arbitration, the arbitrator will have no jurisdiction until a dispute has arisen. But the dispute in either case must be a real one. Generally speaking all matters can, by means of an arbitration agreement, be referred to arbitration. But matters which are purely criminal, and do not give rise to any civil remedy cannot be the subject matter of a reference. Questions of law or fact



may be referred to the arbitrators whether they be trained lawyers or laymen.

### Effect of arbitration agreement

Except as provided by this Act a contract to refer present or future differences to arbitration shall not be specifically enforced, but the party aggrieved may claim damages for breach of contract. But if any person who has made such a contract other than an arbitration agreement to which the provisions of the Arbitration Act of 1940 apply, i.e., where it is not an actual submission but only an agreement to refer, and has refused to perform it, sues in respect of any subject which he has contracted to refer, the existence of such contract shall bar the suit. Under Sec. 34 of the Act the Court before which the proceedings are pending may stay them (Sec. 21 Specific Relief Act, and Sec. 34 Arbitration Act.)

### Provisions applicable to arbitration without the Intervention of the Court

*Provisions implied in arbitration agreement* :— In the absence of a different intention expressed therein, every arbitration agreement shall be deemed to include the following provisions, so far as they are applicable to the reference :— (i) unless otherwise expressly provided the reference shall be to a sole arbitrator; (ii) if the difference is to an even number of arbitrators, they shall appoint an umpire not later than one month from the latest date of the respective appointments; (iii) the arbitrators shall make their award within 4 months after entering on the reference, or after having been called upon to act by a notice in writing from any party to the arbitration agreement, or within such time as extended by the Court; (iv) if the arbitrators fail to make the award within the time allowed to them, or have intimated by notice in writing to the parties, or to the umpire, that they cannot agree, the umpire shall forthwith enter on the reference in lieu of the arbitrators; (v) the umpire shall make his award within 2 months of entering on the reference or within such extended time as the Court may allow; (vi) the arbitrators and the umpire have the power to examine the parties to the reference and the persons claiming under them, who shall also produce all documents and

do all other things which the arbitrators or the umpire may require; (vii) the award shall be binding on the parties and persons claiming under them, respectively; (viii) the arbitrators or the umpire shall have the discretion to award the costs of the reference and determine by whom it shall be paid. (Sec. 3 and schedule I, Arbitration Act.)

The parties may agree that the arbitrator or arbitrators shall be appointed by a person designated in the arbitration agreement. The authority of an appointed arbitrator or umpire shall not be revocable except with the leave of the Court, unless a contrary intention is expressed in the arbitration agreement. An arbitration agreement shall not be discharged by the death of any party thereto, either as respect the deceased or any other party, but shall in such event be enforceable by or against the legal representatives of the deceased. Nor is the authority of an arbitrator revoked by the death of any party by whom he was appointed. Where a term in a contract, to which an insolvent is a party, provides that any difference arising in respect of the same shall be referred to arbitration, the said term shall, if the Official Receiver or Assignee as the case may be, adopt the contract, be enforceable by or against him, so far as it relates to any such difference. The insolvency Court may, even in cases not governed by this rule, having regard to all the circumstances of the case, if it thinks fit, direct that the matter covered by an arbitration agreement to which an insolvent was a party, be determined by arbitration.

#### Power of Court to appoint arbitrator or umpire

In the following cases a Court may appoint an arbitrator or umpire: (i) where the arbitrator or arbitrators have to be appointed by the consent of the parties, and they do not concur in the appointment; (ii) where an appointed arbitrator or umpire neglects or refuses to act, or is incapable of acting, or dies, and the arbitration agreement does not show that the vacancy should not be supplied, and the parties or the arbitrators, as the case may be, do not fill up the vacancy; (iii) where the parties or the arbitrators are required to appoint an umpire, and they do not appoint him.

The Court will make the appointments as stated above only if: (i) a party to the arbitration agreement serves a notice in writing on the other parties or the arbitrators, as the case may be, to concur in the appointment or appointments, or in supplying the vacancy, and (ii) the appointment is not made within 15 days after the service of the said notice, and (iii) an application is made to the Court for the purpose by the party who gave the notice, and (iv) the other parties had an opportunity of being heard in the matter. An arbitrator or umpire appointed by the Court shall have the same powers to act in the reference and to make an award as if he or they had been appointed by the consent of all the parties. (Sec. 8).

#### **When party can appoint new arbitrator or sole arbitrator**

Where an arbitration agreement provides that a reference shall be to two arbitrators, one to be appointed by each party then, unless a different intention is expressed in the agreement;—

(a) if either of the appointed arbitrators neglects or refuses to act, or is incapable of acting, or dies, the party who appointed him may appoint new arbitrator in his place;

(b) if one party fails to appoint an arbitrator either originally or by way of substitution as afore said, for fifteen clear days after the service by the other party of a notice in writing to make the appointment, such other party having appointed his arbitrator before giving the notice, the party who has appointed an arbitrator may appoint that arbitrator to act as sole arbitrator in the reference, and his award shall be binding on both parties as if he had been appointed by consent.

The Court may set aside an appointment as sole arbitrator made under clause (b) above, and either allow further time to the defaulting party to appoint an arbitrator on sufficient cause being shown, or pass other suitable orders. The failure of an arbitrator or an umpire to enter on and proceed with reference within one month after a request to that effect is made by either party may constitute neglect or refusal, within the meaning of section 8 and this section (Sec. 9).

#### **Appointment of three or more arbitrators**

Where an arbitration agreement provides that a reference shall be to three arbitrators, one to be appointed by each party

and the third by the two appointed arbitrators, the agreement shall have the same effect as if it provided for the appointment of an umpire. and not of a third arbitrator by the two arbitrators appointed by the parties. Where the arbitration agreement provides that a reference shall be to three arbitrators to be appointed otherwise than as mentioned above, the award of the majority shall, unless the arbitration agreement otherwise provides, prevail.

#### Power of Court to remove arbitrators or umpire

The Court may remove an arbitrator or an umpire : (i) if he fails to use all reasonable despatch in entering on and proceeding with reference and making an award; (ii) if he has misconducted himself or the proceedings. An arbitrator or umpire who is removed shall not be entitled to receive a remuneration in respect of service. (Sec. 11).

#### Power of Court where arbitrator is removed, or his authority revoked

Where the Court removes an umpire who has not entered on the reference or one or more arbitrators (not being all the arbitrators) the Court may, on the application of any party to the arbitration agreement, appoint persons to fill the vacancies. Where the authority of an arbitrator or an umpire is revoked by leave of the Court, or where the Court removes an umpire who has entered on the reference, or a sole arbitrator, or all the arbitrators, the Court may on the application of any party to the arbitration agreement, either (i) appoint a person to act as sole arbitrator in the place of the person or persons displaced, or (ii) order that the arbitration agreement shall cease to have effect with respect to the difference referred. A person thus appointed as arbitrator or umpire shall have the same powers, as if he had been appointed in accordance with an arbitration agreement.

#### Powers of the arbitrator

An arbitrator or umpire has got the following powers in the absence of a different intention expressed in the agreement:—

(i) administer oath to parties and witnesses, (ii) state a special case for the opinion of the Court on any question of law, (iii) make the award conditional or in the alternative, (iv) correct

in an award any clerical mistake or error arising from any accidental slip or omission, (v) administer to any party interrogatories.

*Note:* An award by the arbitrators or umpire should be signed and should be stamped, the fee for which can be collected from the parties. The arbitrator or umpire shall at the request of any party, or if directed by the Court, file the award, the depositions, documents etc. before Court. Where the Court gives an opinion on a special case referred to it, it shall form part of the award.

#### Power of Court to modify award

An award may be modified or corrected by the Court : (i) where it appears that a part of the award is upon a matter not referred to arbitration, and such part can be separated from the other part without affecting the decision on the matter referred, or (ii) where it is imperfect in form, or contains an obvious error which can be corrected without affecting the decision, or (iii) where the award contains clerical mistake or error or accidental slip or omission (Sec. 15).

#### Power to remit award

An award or any matter referred to arbitration may be referred to arbitrator or umpire for reconsideration in the following cases: (i) where the award has not determined any matter referred to arbitration, or where it determines any matter not referred to arbitration, and such matter cannot be separated without affecting the determination of the matters referred; or (ii) where the award is so indefinite as to be incapable of execution; or (iii) where an objection to the legality of the award is apparent on the face of it. Where an award is so remitted, the arbitrator shall submit his decision to the Court within the time fixed by it, and in default the award shall become void (Sec. 6.)

#### Judgment in terms of award

Where the Court does not remit the award or any of the matters referred to arbitration for reconsideration, or set aside the award, the Court shall, after the time for making the application to set aside the award has expired, or such application though made was refused, proceed to pronounce judgment according to

the award, and upon the judgment pronounced a decree shall follow. There shall be no appeal against such a decree except on the ground that (i) it is in excess of the award, or (ii) it is not otherwise in accordance with the award (Sec. 17.)

*Note:—*After an award is filed the Court may pass the necessary interim orders in order to prevent any party who has taken or is about to take steps to defeat, delay, or obstruct the execution of any decree that may be passed on the award, or for the speedy execution of the award. Where an award has become void by reason of the arbitrator or umpire not submitting the decision within the time fixed by the Court while remitting the award, it may by order supersede the reference, and shall thereupon order that the arbitration agreement shall cease to have effect with respect to the difference, and the Court shall proceed with the suit.

### Arbitration with intervention of Court where there is no suit pending

#### *Application to file in Court arbitration agreement :—*

(i) Where any persons have entered into an arbitration agreement before the institution of a suit with respect to the subject-matter of the agreement, or any part of it, and where a difference has arisen to which the agreement applies, they or any of them, instead of proceeding under Chapter I may apply to a Court having jurisdiction in the matter to which the agreement relates, that the agreement be filed in the Court.

(2) The application shall be in writing and shall be numbered and registered as a suit between one or more of the parties interested or claiming to be interested as plaintiff or plaintiffs, and the remainder as defendant or defendants, if the application has been presented by the parties, or, if otherwise, between the applicant as plaintiff and the other parties as defendants.

(3) On such application being made, the Court shall direct notice thereof to be given to all parties to the agreement other than the applicants, requiring them to show cause within the time specified in the notice, why the agreement should not be filed.

(4) Where no sufficient cause is shown, the Court shall order the agreement to be filed, and shall make an order in

reference to the arbitrator appointed by the parties, whether of the agreement or otherwise, or where the parties cannot agree upon an arbitrator, to an arbitrator appointed by the Court.

(5) Thereafter the arbitration shall proceed in accordance with, and shall be governed by the other provisions of this Act so far as they can be made applicable. (Sec, 20.)

### Arbitration in suits

Where all the parties in any suit agree that any matter in difference between them in the suit shall be referred to arbitration they may at any time before judgment is pronounced, apply in writing to the Court for an order of reference. The arbitrator shall be appointed in such manner as may be agreed upon between the parties. The Court shall by order refer to the arbitrator the matter in difference which he is required to determine and shall in the order specify such a time as he thinks reasonable for the making of the award. The Court shall not thereafter deal with the suit except as provided by the Act. Where only some of the parties to a suit apply to have the matter in difference between them referred to arbitration, and such matters can be separated from the rest of the subject matter of the suit, the Court may refer the matters in difference between the parties to arbitration, but shall continue the suit so far as it relates to the other parties, and to the matter not contained in the said reference, and an award made in pursuance of such a reference shall be binding only on the parties who have joined the application. The other provisions in the Act shall apply to arbitrations in suits so far as they can be made applicable. The Court may instead of appointing an arbitrator or umpire as mentioned in Sec. 8, or removing arbitrators or umpire under Sec. 11, or filling up the vacancies of the three arbitrators, or exercising the powers mentioned in Sec. 10 and 12, make an order superseding the arbitration and proceed with the suit.

### General provisions applicable to all arbitrations

The following provisions apply to all arbitrations (Sec. 26):—

(1) The arbitrators or the umpire may, in the absence of a different intention in the arbitration agreement, make an interim award.

(2) The Court may when it thinks fit enlarge the time for making the award. A provision in the arbitration agreement empowering the arbitrators or umpire to enlarge the time for making the award, except with the consent of all the parties to the agreement, is void and of no effect.

(3) Whenever an award is for the payment of money, the Court may award interest from the date of the decree at a reasonable rate to be paid on the principal sum decreed.

(4) An award shall not be set aside except on one or more of the following grounds : (i) that an arbitrator or umpire has misconducted himself or the proceedings ; (ii) that an award has been made after the arbitration has been superseded, or the proceedings have become invalid because of legal proceedings upon the subject matter of the entire reference having been commenced between all the parties to the reference, and notice of the same given to the arbitrators or umpire ; (iii) that an award has been improperly procured or is otherwise invalid.

(5) The Court having jurisdiction in the matter to which the reference relates is the Court in which an award may be filed. All questions regarding an arbitration agreement or the award shall be decided by the Court in which the award under the agreement has been, or may be filed, and by no other Court. All applications regarding the conduct of arbitration proceedings or otherwise arising out of such proceedings shall be made to the Court where the award has been or may be filed, and to no other Court. Once an application under this Act has been made in a competent Court that Court alone shall have jurisdiction over the arbitration proceedings and all subsequent applications arising out of that reference, and the arbitration proceedings shall be made in that Court only.

(6) No suit shall lie on any ground whatever for a decision upon the existence, effect, or validity of an arbitration agreement, or award. Nor shall an arbitration agreement or award be set aside, amended, modified or in any way affected, otherwise than as provided in the Act.

(7) If any party to an arbitration agreement desire to challenge the existence or validity of the same, or of an award, or to have the effect of either determined, he shall apply to the Court and it shall decide the question on affidavits and other evidence



(8) When a party to an arbitration agreement commences legal proceedings against the other party to it, any party to such legal proceedings may at any time before filing a written statement, or taking other steps in the proceedings apply to the Court to stay the proceedings, and if it is satisfied that there is no sufficient reason for the matter not being referred in accordance with the arbitration agreement, and that the applicant is ready and willing to do all things necessary to the proper conduct of the arbitration, may make an order staying the proceedings.

(9) Where the legal proceedings have not been stayed as aforesaid, and they relate to the entire subject matter of the reference, and the arbitrators or the umpire have notice of the same and yet proceed with the arbitration, the further proceedings shall be invalid. But the mere fact that legal proceedings have been commenced would not render the reference or award invalid.

(10) The provisions of the Civil Procedure Code shall apply to all proceedings before the Court, and all appeals under this Act. The Court may exercise powers mentioned in the II Schedule in arbitration proceedings viz., to pass orders for the preservation, interim custody, or sale of any goods which are the subject matter of the reference, or issue an injunction or appoint a receiver for detention, preservation or inspection etc., of any property, which is subject of the reference.

(11) The Court shall issue process to the parties and witnesses, whom the arbitrator or umpire desires to examine as in a suit tried before it, and also pass other incidental orders.

(12) The High Court is empowered to make rules consistent with the Act to give effect to its provisions.

(13) The provisions of the Act shall be binding on the Crown.

(14) The provisions of this Act are generally made applicable to arbitrations under other enactments, as if that other enactments were an arbitration agreement, and to all proceedings under such arbitrations. (Secs. 27 to 38).

### Appeals

An appeal shall lie from the following orders passed under this Act, to the Court authorised to hear appeals from original

decrees of the Court passing the order : (i) an order superseding an arbitration; (ii) an order on an award stated in the form of a special case; (iii) an order modifying or correcting an award; (iv) an order filing or refusing to file an arbitration agreement; (v) an order staying or refusing to stay legal proceedings where there is an arbitration agreement ; (vi) an order setting aside or refusing to set aside an award.

*Note:* - An appeal shall not lie against any order passed by a Small Cause Court. A second appeal shall not lie from an order passed in appeal preferred in any of the cases mentioned above. (Sec. 39.)

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## APPENDIX—A

### The Factories Act

The law governing factories in British India is to be found in the Factories Act XXV of 1934, as amended from time to time. The chief objects of factory legislation are: (i) to protect those employed in factories from being subjected to unduly long hours of bodily strain or manual labour; (ii) to provide healthy and sanitary conditions of work; and (iii) to provide a manufacturing process involving minimum risk to the employees. The present Act with its amendments has indeed achieved much in the interests of factory labour.

#### Definitions

*'Adolescent'* means a person who has completed his fifteenth but has not completed his seventeenth year.

*'Adult'* means a person who has completed his seventeenth year.

*'Child'* means a person who has not completed his fifteenth year.

*'Power'* means electrical energy, and any other form of energy which is mechanically transmitted and is not generated by human or animal agency.

*'Manufacturing process'* means any process:—

(i) for making, altering, repairing, ornamenting, finishing or packing, or otherwise treating any article or substance with a view to its use, sale, transport, delivery or disposal, or

(ii) for pumping oil, water, or sewage, or

(iii) for generating, transforming or transmitting power.

*'Worker'* means a person employed whether for wages or not, in any manufacturing process, or in cleaning any part of the machinery or premises used for a manufacturing process, or in any other kind of work whatsoever, incidental to, or connected with the manufacturing process, or connected with the subject of the manufacturing process, but does not include any person

solely employed in a clerical capacity in any room or place where no manufacturing process is being carried on.

'*Factory*' means any premises including the precincts thereof whereon *twenty or more* workers are working, or were working on any day of the preceding twelve months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, but does not include a mine subject to the operation of the Indian Mines Act, 1923.

'*Machinery*' includes all plant whereby power is generated, transformed, transmitted or applied:

'*Occupier*' of a factory means the person who has ultimate control over the affairs of the factory; provided that where the affairs of a factory are entrusted to a managing agent, such agent shall be deemed to be the occupier of the factory (Sec. 3).

'*Seasonal factory*': For the purposes of this Act, a factory which is exclusively engaged in one or more of the following manufacturing processes, namely, cotton ginning, cotton or jute pressing, the decortication of ground nuts, the manufacture of coffee, indigo, lac, rubber, sugar (including gur) or tea, or any manufacturing process which is incidental to or connected with any of the aforesaid processes, is a seasonal factory:

Provided that the Provincial Government may, by notification in the official Gazette, declare any such factory in which manufacturing processes are ordinarily carried on for *more than one hundred and eighty working days* in the year, not to be a seasonal factory for the purposes of this Act. The Provincial Government may by notification in the official Gazette, declare any specified factory in which manufacturing processes are ordinarily carried on for *not more than one hundred and eighty working days* in the year, and cannot be carried on except during particular seasons or at times dependent on the irregular action of natural forces, to be a seasonal factory for the purposes of this Act. (Sec. 4).

'*Small factory*' means any premises including the precincts thereof, whereon 10 or more, but less than 20 workers are working, or were working, on any day of the preceding 6 months, and in any part of which a manufacturing process is being carried on with the aid of power, or is ordinarily so carried on, but it does

not include a mine. Many of the provisions relating to children are made applicable to small factories, wherein children are employed.

*Note* :—Though the Act is applicable only to factories *i.e.*, premises wherein 20 or more workers are or were working, and on any part of which a manufacturing process is carried on with power, S. 5 empowers the Provincial Government to apply all or any of the provisions of the Act to any place wherein a manufacturing process is carried on with or without the use of power, whenever 10 or more workers are working therein, or have worked therein, on any one day of the 12 months immediately preceding.

*The Inspecting Staff* :—The Act empowers the Provincial Government to appoint officers called Inspectors, and a Chief Inspector, for giving effect to its provisions. Every District Magistrate is made an *ex-officio* Inspector for his district. The Inspectors are empowered : (i) to enter any place which is, or he reasonably believes to be a factory, (ii) to make such examination of the premises and plant and the prescribed registers, and also take the evidence of any persons for carrying out the purpose of the Act, and (iii) exercise other powers necessary for carrying out the purposes of the Act.

*Certifying Surgeons* :—The Provincial Government is authorised to appoint registered Medical Practitioners to be certifying surgeons for the purposes this Act.

### Health and safety

Chapter III of the Act embodies a number of provisions intended to secure the health and safety of the factory workers. Every factory is required to be kept clean and free from effluvia arising from any drain, privy or other nuisance, and to be properly cleansed and washed. Further a factory shall be ventilated in accordance with the prescribed standards and such methods as would prevent injury to the health of workers, on account of gas, dust, or other impurity which may be generated in the course of work, if necessary by providing mechanical or other devices for the purpose. The Government is required to make rules prescribing standards in respect of artificial humidification in factories. Further no room in a factory shall be crowded in working hours to a dangerous extent, or to an extent which may be

injurious to the health of workers, and every factory shall be sufficiently lighted during all working hours. The occupier of every factory should provide for the workers at a suitable place sufficient supply of water fit for drinking, and also of water suitable for washing obnoxious or injurious substances with which workers may come into contact in the course of their work. Every factory must have sufficient number of latrines, and urinals, according to prescribed standards. The doors of each room in which more than 20 persons are employed shall, except in the case of sliding doors, be constructed so as to open outwards, or where the door is between two rooms it should open in the direction of the nearest exit, and no such door shall be locked or obstructed during working hours. In every factory all precautions against fire, as are prescribed, should be taken and such means of escape in cases of fire as can be reasonably required, should also be provided.

One important provision made with a view to secure the safety of workers is embodied in S. 24 of the Act, which lays down that the following shall be kept adequately fenced, viz.

(a) every exposed moving part of a prime mover, and every fly wheel directly connected to a prime mover ;

(b) every hoist or lift, hoist-well or lift-well, and every trap door or similar opening near which any person may have to work or pass; and

(c) every part of the machinery which the Provincial Government may prescribe.

The said fencing should always be maintained in an efficient state.

The Inspector is empowered to require the manager of the factory to provide him with such specification, and other particulars, so as to enable him (the inspector) to verify whether the building, ways, machinery or plant can be used with safety and without danger to human life. The Inspector may also require the manager to adopt such measures as are necessary in order to render them reasonably safe for use, and if they are in such a condition as involving imminent danger, he may require the manager to prohibit their use, until properly repaired or altered. Where more than 150 workers are employed in a factory adequate shelter shall be provided for their use during periods of rest. (Secs. 13 to 27)

**Special provisions relating to Women, Children, and Adolescents**

As a rule women and children are not allowed to clean or oil any part of the machinery of a factory when, it is in motion under power, or work between moving parts of a machinery, or between fixed and moving parts of any machinery which is in motion under power. In certain classes of factories, the Government may altogether prevent children from being employed. Further women and children shall not be employed in any part of a factory for pressing cotton in which a cotton opener is at work. The Government may frame rules requiring that in any specified factory wherein more than 50 women workers are employed, a suitable room shall be reserved, for the use of their children under the age of 6 years, and also make provision for supervision over those children. The Provincial Government may prohibit or restrict the employment of women, adolescents, or children from being employed on hazardous operations i.e., those operations which in the opinion of the Government expose any person employed in the factory in which it is carried on, to a serious risk of bodily injury, poisoning, or disease. (Sec. 27 to 29).

It is also laid down that even in the case of seasonal factories women cannot be made to work for more than 10 hours in any day, and that women shall not be permitted to work in a factory ordinarily except between 6 A.M. and 7 P.M., though the Provincial Government may, by a notification vary the said limits in respect of any class or classes of factories to any span of certain hours between 5 A.M. and 7-30 P.M.

A child who has not completed his twelfth year shall not be allowed to work in any factory. In the case of any young person i.e. an adolescent or a child, who has completed 12 years, who wishes to work in a factory, the certifying surgeon is required to examine him and ascertain his fitness for such work, and grant: (a) a certificate of fitness to work in a factory as a *child*, if he is satisfied that such person has completed his *12th year*, that he has attained the prescribed physical standard (if any), and that he is fit for such work; (b) a certificate of fitness to work in a factory as an *adult*, if he is satisfied that such person has completed his *fifteenth year* and is fit for a full day's work in a factory. It may therefore be noted that it is the certifying surgeon that has to decide whether an adolescent is to be permitted to

work as an adult or child, depending on his physical fitness. A certificate after it is granted as aforesaid, may be revoked by the certifying surgeon, if in his opinion the holder of it is no longer fit to work in the capacity stated therein in a factory. An adolescent to whom a certificate of fitness to work as an adult is granted, will be deemed to be an adult for purposes of hours of work etc., and similarly an adolescent who is not granted such a certificate shall be deemed only to be a child for the purposes of this Act. (Secs. 51 to 53).

No child shall be allowed to work in a factory for more than *5 hours in any day*, and the hours of work shall be so arranged that they shall not spread over more than  $7\frac{1}{2}$  *hours, in any day*. Further no child shall be allowed to work in a factory except between 6 A.M. and 7 p.m., except when the Provincial Government by a notification varies those limits to a span of 13 hours, within 5 A.M. and 7.30 P.M. in respect of any class or classes of factories.

No child shall be allowed to work in any factory on any day, on which he has already been working in another factory. The manager of every factory is required to maintain a register of child workers containing all necessary particulars, which would reveal whether the provisions in respect of the children have been complied with or not. (Sec. 54 and 55).

#### Restrictions on working hours of adults

The Act lays down that an adult worker shall not be allowed to work in a factory for more than *54 hours in a week*, or where the factory is a *seasonal factory* for more than *60 hours in any week*. If an adult worker in a non-seasonal factory is engaged in work, which for technical reasons must be continuous throughout the day, he may work for 56 hours in any week. (Sec. 34).

*Note:* The Central Assembly passed an Act in April 1946 reducing the maximum weekly hours of work from 54 to 48 in the case of perennial (non-seasonal) factories, and from 60 to 50 in the case of seasonal factories, which would come into force from August 1946.

No adult worker shall be allowed to work on a Sunday, unless he has had, or will have a holiday, for a whole day on one of the three days immediately before or after that Sunday, and that



fact has been intimated by a notice to the inspector, and the notice is also displayed in the factory. By an Amending Act (Act III of 1945) it has been laid down that where by reason of an order or a rule under the provisions of the Factories Act, a worker is deprived of a weekly holiday, to which he is entitled under Section 35, he shall be allowed as soon as circumstances permit, *compensatory holidays* of equal number to the holidays so lost.

No adult worker shall be allowed to work in a factory for more than 10 hours in any day but a male adult worker may work in a seasonal factory for 11 hours in any day. The periods of work of adult workers shall be fixed so that no period shall exceed 6 hours, and no worker shall work for more than 6 hours, before he has had an interval for rest of at least one hour. In the alternative no period shall exceed five hours, and no worker shall work for more than five hours before he has had an interval for rest of at least half-an hour, or for more than 8½ hours, before he has had at least two such intervals. The said periods of work shall be so arranged that along with the intervals for rest they shall not spread over more than 13 hours in any day, except with the permission of the Provincial Government. The manager of every factory is required to maintain a register showing details which would enable the inspecting staff to be satisfied that the Provisions of the Act have been complied with. Where a worker works on a shift which extends over mid-night, the ensuing day for him shall be deemed to be the period of 24 hours beginning when such shift ends, and the hours he has worked after mid-night shall be counted towards the previous day. The Provincial Government may direct in the case of any factory that the ensuing day shall be deemed to be a period of 24 hours beginning when such shift begins, and that the hours worked before the mid-night shall be counted towards the ensuing day. (Secs. 34 to 38).

Where a worker works for more than 60 hours in any week, or in the case of seasonal factory for more than 10 hours in any day, he shall be entitled in respect of the overtime work to pay at the rate of 1½ times his ordinary rate of pay. If a worker in a factory, other than a seasonal factory, works for more than 54 hours in any week, he shall be entitled in respect of the overtime worked, excluding any overtime in respect of which he is entitled to extra pay under the previous rule, to pay at the rate of 1½ times his ordinary rate of pay.

*Note :—*The Central Assembly recently passed an Act which will step up over time wages to double the ordinary rate.

An adult worker shall not be allowed to work in any factory on any day on which he has already been working in another factory.

The Factories Amendment Act III of 1945 has added a new Chapter IV-A entitled 'Holidays with Pay'. According to it every worker who has completed a period of 12 months continuous service in a factory, shall be allowed during subsequent period of 12 months, holidays for a period of 10 or, if a child 14, consecutive days, inclusive of the day or days, if any, on which he is entitled to a holiday under the Act. If a worker does not avail himself of all the holidays so allowed, any holidays not taken by him shall be added to the holidays to be allowed to him in the succeeding period of 12 months. But the total number of holidays which may be carried forward to a succeeding period shall not exceed 10 or in the case of a child 14. The Amendment Act also lays down that during the additional holidays, now provided, he shall be paid at a rate equivalent to the daily average of his wages as defined in the Payment of Wages Act 1936, during the preceding 3 months, exclusive of any earnings in respect of overtime.

*Note :—*With a view to secure strict compliance with the provisions of the Factories Act, contravention of the provisions of the Act in a majority of cases is made punishable with fine.

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## APPENDIX—B

### The Workmen's Compensation Act (VIII of 1923)

*Preliminary*:—With a view to provide for the payment of compensation to workmen, or their dependants, as the case may be, for injuries sustained by the workmen, while in the course of employment, the legislature has passed the Workmen's Compensation Act of 1923. The chief advantages resulting from this Act are : (i) it creates liability on the part of the employers to pay compensation whenever injuries are sustained by the workmen ; (ii) the amount of compensation that can be claimed is also rendered certain ; (iii) the procedure by which it can be claimed is made very simple ; (iv) the workmen's claim cannot be defeated by any of the pleas which can be raised in an ordinary suit for damages ; and (v) the workmen's rights to compensation are protected against the insolvency of the employer.

#### Definitions

*Adult* and *Minor* mean respectively a person who is not, and a person who is under the age of 15 years.

*Commissioner* means a Commissioner for Workmen's Compensation appointed by the Provincial Government under Sec. 20.

*Dependant* means any of the following relatives of a deceased workman : (i) a widow, minor legitimate son, and unmarried legitimate daughter or a widowed mother ; and (ii) if wholly or in part dependant on the earnings of the workman at the time of his death, the widower, a parent other than a widowed mother, a minor illegitimate son, an unmarried illegitimate daughter, a daughter legitimate or illegitimate if married and a minor or if widowed, a minor brother, an unmarried or widowed sister, a widowed daughter-in-law, a minor child of a deceased son, a minor child where no parent of the child is alive, a paternal grandparent.

*Employer* includes any body of persons whether incorporated or not, and any managing agent of an employer, and the legal representative of a deceased employer, and when the services are temporarily lent or let on hire to another by the person with

whom the workman has entered into a contract of service or apprenticeship means, such other person while the workman is working for him.

- *Partial Disablement* means where the disablement is of a temporary nature, such disablement as reduces the earning capacity of a workman in any employment in which he is engaged at the time of the accident resulting in his disablement, and where the disablement is of permanent nature such disablement as reduces his earning capacity in every employment which he was capable of undertaking at that time ; provided that every injury specified in schedule I, shall be deemed to result in permanent partial disablement.

*Total Disablement* means such disablement whether of a temporary or permanent nature, as incapacitates a workman for all work which he was capable of performing at the time of accident resulting in such disablement : provided that permanent total disablement shall be deemed to result from the permanent total loss of sight of both eyes, or any combination of injuries specified in schedule I where the aggregate percentage of the loss of earning capacity as specified in that schedule against those injuries amounts to 100%.

*Wages* include any privilege or benefit which is capable of being estimated in money, other than a travelling allowance, or the value of any travelling concession, or a contribution paid by the employer of a workman to cover any special expenses entailed on him by the nature of the employment.

*Workman* means any person (other than a person whose employment is of a casual nature and who is employed otherwise than for the purposes of the employer's trade or business) who is (i) a railway servant as defined in Sec. 3. of the Indian Railways Act 1890, not permanently employed in an administrative, district or sub-divisional office of a railway, and not employed in any such capacity as is specified in schedule II, or (ii) employed on monthly wages not exceeding 300 rupees in any such capacity as specified in the schedule II, whether the contract of employment was made before or after the passing of this Act and whether such contract is expressed or implied, oral or in writing, but does not include any person working in the capacity of a member of His Majesty's naval, military, or air forces, or of the

Royal Indian Marine service; and any reference to a workman who has been injured shall, where the workman is dead, include a reference to his dependants or any of them.

*Note :—*The exercise and performance of the powers and duties of a local authority or of any department of the Government shall for the purposes of this Act, unless a contrary intention appears, be deemed to be the trade or business of such authority or department. Schedule II of the Act gives a list of persons who are included in the definition of workmen in the Act, considering the risk involved, or the hazardous nature of the occupation on which they are employed. The list is fairly exhaustive but the Governor General in Council is still given the power to add any class of persons employed in any occupation, which he is satisfied is a hazardous occupation, to the said list by means of a notification in the Gazette, so as to make the provisions of the Act applicable to them. It is also provided that the Governor General in Council may direct that the provisions of this Act shall apply to such classes of persons only in respect of specified injuries. (Sec. 2).

### Employer's liability for compensation

Sec. 3 lays down that if a personal injury is caused to a workman by an accident arising out of, and in the course of his employment, his employer shall be liable to pay compensation in accordance with the provisions of Chapter II of the Act. It may therefore be noted that the employer is made almost to insure the safety of the workmen, to whom the Act applies. His liability therefore does not depend on any negligence on his part. In a case where an injury was caused by the fall of the roof of the premises in which a workman was working, by reason of an earth-quake, it was held to be an accident arising out of and in the course of the employment, and the employer was made liable for compensation. Even contributory negligence on the part of the employee would not exonerate the employer from liability to compensate the employee, if the accident could not have been avoided by the exercise of ordinary care and diligence.

This salutary provision only indicates the anxiety of the legislature to secure to every workman, within the meaning of the Act, compensation for the injuries sustained by him on account of his employment, without having to suffer the technical pleas,

and delay, which generally accompany an ordinary action at law for damages for injuries. With this object it has also been laid down that except as provided by this Act no lump sum or half-monthly payment payable under this Act shall, in any way, be capable of being assigned or charged, or be liable to attachment, or pass to any person other than the workman by authorisation of law, nor shall any claim be set off against the same. Further Sec. 17 provides that any contract or agreement, whether made before, or after the commencement of this Act, whereby a workman relinquishes any right of compensation from the employer for a personal injury, arising out of, or in the course of employment, shall be null and void, in so far as it purports to remove or reduce the liability of any person to pay compensation under this Act.

*Insolvency of employer:*—With the same object S. 14 lays down that where any employer has entered into a contract with any insurers in respect of any liability under this Act to any workman, then in the event of his employer becoming insolvent, or making composition or scheme of arrangement with his creditors, or, if the employer is a company, in the event of the company having commenced to be wound up, the rights of the employer against the insurers as respects that liability, shall, notwithstanding anything in any law for the time being in force relating to insolvency, or the winding up of companies, be transferred to and vest in the workman, and upon any such transfer the insurers shall have the rights and remedies and be subject to the same liabilities as if they (insurers) were the employers. But the insurers shall not be under any greater liability to the workman than they would have been under to the employer. If the liability of the insurers to the workman is less than the liability of the employer to the workman, he may prove for the balance in the insolvency proceedings or liquidation. Except where the employer has not complied with the terms or conditions relating to the payment of the premia, in other cases, even if a contract between the insurers and the employer is void or voidable by reason of non-compliance by the employer with any terms of the contract, the liability of the insurers as stated above remains in force, and the insurers shall be entitled to prove in the insolvency or liquidation proceedings, as the case may be, for the amount paid to the workman.

Further Sec. 14 confers an additional privilege on the workman by laying down that the amount of compensation for which an insolvent employer becomes liable under the Act, where it accrued before the date of order of the adjudication, or commencement of the winding up as the case may be, could be claimed by him as a preferential debt in the distribution of the property of the insolvent, or the distribution of the assets of the company which is being wound up, under Sec. 49 P.T.I. Act or Sec. 51 of P.I. Act, or under Sec. 230 of the Companies Act as the case may be. It may be noted that even in cases where the employer contracts with another person for the execution of the whole or any part of any work which is ordinarily part of the business of the employer, the employer shall be liable to pay compensation to the workman employed in the execution of such work, as if he were employed directly under the employer. The workman may however recover compensation from the other person by whom he was immediately employed, instead of claiming it from his employer.

#### When employer not liable

The employer will not be liable to pay compensation in the following cases :—

(1) in respect of any injury which does not result in the total or partial disablement of the workman for a period exceeding seven days;

(2) in respect of any injury, not resulting in death, caused by an accident which is directly attributed to—

(i) the workman having been at the time thereof under the influence of drink or drugs, or

(ii) the wilful disobedience of the workman to an order expressly given, or to a rule expressly framed, for the purpose of securing the safety of workmen, or

(iii) the wilful removal or disregard by the workman of any safety, guard, or other device, which he knew to have been provided for the purpose of securing the safety of workmen.

The employer will be liable to pay compensation to a workman who employed in any employment specified in Part A of Schedule III contracts any disease which is peculiar to his occupation (called occupational disease) specified therein viz. (i) anthrax

(ii) compressed air illness or its sequae lae, (iii) poisoning by lead terra ethyl, (iv) poisoning by nitrous fumes, and also to a workman who whilst in service of the employer for continuous period of not less than 6 months in any employment specified in Part B of Schedule III contracts any diseased specified therein viz., lead poisoning, phosphorous poisoning, mercury poisoning, poisoning by benzene, chrome ulceration, as if that disease is an injury or an accident arising out of and in the course of his employment. Where a workman wants to claim compensation for any other disease he must establish that it is directly attributable to a specific injury by accident arising out of, and in the course of his employment.

(3) A workman shall not be entitled to compensation in respect of any injury if he has instituted in a civil Court a suit for damages in respect of the injury against the employer or any other person. Similarly a workman shall not be entitled to maintain a suit for damages in any Court of law in respect of any injury if he has instituted a claim to compensation under the Act, or if he has entered into an agreement with the employer providing for the payment of compensation in accordance with the Act. (Sec. 3)

#### Amount of Compensation

The amount of compensation payable shall be as follows :—

1. Where death results from the injury the compensation (i) in the case of an *adult* in receipt of monthly wages falling within the limits shown in the first column of Schedule IV—the amount shown against such limits in the second column thereof. Thus according to the said schedule if an adult getting not more than Rs. 10 per month dies, the amount of compensation will be Rs. 500, while if he gets any amount above Rs. 200 the compensation will be Rs. 4,000. If the wages are between the limits of Rs. 10 and Rs. 200, the compensation will be approximately 30 times the monthly wages;

(ii) In the case of the death of a *minor* the compensation payable is Rs. 200.

2. Where *permanent total disablement* results from the injury: (i) in the case of an *adult* in receipt of monthly wages within the limits shown in the first column of Schedule IV, the amount shown against such limits in the third column thereof. Thus if



the monthly wages are not more than Rs. 10 the compensation is Rs. 700 and if the wages are more than Rs. 200 it is Rs. 5,600. In all other cases the compensation is fixed at little less than  $1\frac{1}{2}$  times the compensation payable in the case of death. The reason for paying more compensation in the case of total disablement is obvious, because in addition to the loss sustained by dependants of the workman thereby, the workman himself has to be maintained till his death;

(ii) In the case of a *minor* Rs. 1,200.

3. Where permanent *partial disablement* results from the injury;—

(i) in the case of an injury specified in Schedule I, (below) such percentage of the compensation which would have been payable in the case of permanent total disablement as is specified therein as being the percentage of the loss of earning capacity caused by the injury, and

(ii) in the case of an injury not specified in Schedule I, such percentage of the compensation payable in the case of permanent total disablement as is proportionate to the loss of earning capacity permanently caused by the injury ;

Explanation.—Where more injuries than one are caused by the same accident, the amount of compensation payable under this head shall be aggregated, but not so in any case as to exceed the amount which would have been payable if permanent total disablement had resulted from the injuries. (Sec. 4).

### Schedule I

List of injuries deemed to result in permanent partial disablement.

Injury	Percentage of loss of earning capacity
Loss of right arm above or at the elbow	70
Loss of left arm above or at the elbow	60
Loss of right arm below the elbow	60
Loss of leg at or above the knee	60
Loss of left arm below the elbow	50
Loss of leg below the knee	50
Permanent total loss of hearing	50
Loss of one eye	30
Loss of thumb	25
Loss of all toes of one foot	20
Loss of one phalanx of thumb	10
Loss of index finger	10
Loss of great toe	10
Loss of any finger other than index finger	5

*Note* : Complete and permanent loss of the use of any limb or member referred to in this schedule shall be deemed to be equivalent of the loss of that limb or member.

(4) Where *temporary disablement* whether *total* or *partial* results from the injury, a half-monthly payment payable on the sixteenth day after the expiry of a waiting period of seven days from the date of the disablement, and thereafter half-monthly during the disablement or during the period of 5 years, whichever period is shorter,—

(i) in the case of an *adult* in receipt of monthly wages falling within the limits shown in the first column of Schedule IV—of the sum shown against such limits in the fourth column thereof (i.e., roughly between  $\frac{1}{2}$  and  $\frac{3}{20}$  of the monthly wages, the amount diminishing as the wages increase).

(ii) in the case of a *minor*—of one half of the monthly wages subject to a maximum of Rs. 30.

*Note* :—There shall be deducted from any lump sum or half monthly payment to which a workman is entitled the amount of any payment or allowance which the workman has received from the employer by way of compensation during the period of disablement prior to receipt of such lump sum or of the first half monthly payment, as the case may be. (Sec. 4).

### Calculation of Monthly Wages

For the purposes of this Act the monthly wages of workman shall be calculated as follows :—

1. Where the workman has, during a continuous period of not less than twelve months immediately preceding the accident, been in the service of the employer, who is liable to pay compensation, the monthly wages of the workman shall be one-twelfth of the total wages which have fallen due for payment to him by the employer in the last twelve months of that period ; where the continuous period of service immediately preceding the accident during which the workman was in the service of the employer who is liable to pay compensation is less than one month, the monthly wages shall be deemed to be the average monthly amount during the twelve months—immediately preceding the accident which was earned by workman employed in the same work by the same employer, or by a workman employed in similar work in the same locality.

2. In other cases the monthly wages shall be—30 times the total wages earned in respect of the last continuous period of service immediately preceding the accident from the employer who is liable to pay compensation, divided by the number of days comprising such period. (Sec. 5).

### Deposit and Distribution of Compensation

The Act lays down that the payment of compensation in respect of a workman whose injury has resulted in death, and in respect of a woman, or a man under disability should be made by deposit with the Commissioner. In the case of a deceased workman however, the employer may make advances to any dependant on account of compensation not exceeding Rs. 100, and the same shall be deducted by the Commissioner from the compensation payable and repay it to the employer. In other cases where the amount of compensation payable is not less than Rs. 10 the sum may be deposited with the Commissioner on behalf of the person entitled thereto. The receipt of the Commissioner shall be a sufficient discharge in respect of any compensation deposited with him. Out of the amount deposited with the Commissioner as compensation in respect of a deceased workman, he shall deduct the actual cost of the workman's funeral expenses to an amount not exceeding Rs. 25 and pay the same to the person who incurred such expenses. The Commissioner shall, if he thinks fit, cause notice to be published or to be served on each dependant, calling upon the dependants to appear before him, to determine the distribution of the compensation. If the Commissioner is however satisfied upon enquiry that no dependant exists, he shall repay the balance of the money to the employer by whom it was paid. Compensation deposited in respect of a deceased workman shall, subject to deduction made as aforesaid for funeral expenses, be apportioned among the dependants of the deceased workman, or any of them, in such proportion as the Commissioner thinks fit, or may in the discretion of the Commissioner be allotted to any one dependant. The said amount may be paid by the Commissioner to the person entitled thereto, unless such person is a woman, or a person under legal disability, in which case the said sum may be invested, applied, or otherwise dealt with for the benefit of such person. The Commissioner is also given the power to vary any order made by him apportion-

ing the amount of compensation among the dependants, e.g., where he is satisfied that the parent to whom compensation has been paid has neglected the children of the deceased, or on account of variation of the circumstances of any dependant, or for any other sufficient cause.

### Notice and Claim

Sec. 10 lays down that no proceedings for the recovery of compensation shall be maintainable before a Commissioner unless a notice of the accident has been given in the manner specified, as soon as practicable after the happening thereof, and before the workman has voluntarily left the employment in which he was injured. Further it is necessary that the claim for compensation with respect to such accident should be instituted within 6 months of the occurrence of the accident, or in case of death within 6 months from the date of death. The Commissioner is given the power to admit and decide any claim to compensation in any case notwithstanding that no such notice has been given, or that the claim has not been instituted within 6 months, if he is satisfied that such default was due to sufficient cause. The notice referred to above, shall give the name and address of the person injured and shall state in ordinary language the cause of the injury, and the date on which the accident happened and shall be served on the employer. It may be served by delivering it at, or sending it by registered post addressed to the residence or any office or place of business of the person on whom it is to be served, or where a notice book is maintained, by an entry in such notice book.

### Medical Examination

Section 11 requires that every one who has given notice of an accident shall, when the employer, before the expiry of 3 days from the time at which service of the notice has been effected, offers to have him examined free of charge by a qualified medical practitioner, submit himself for such examination, and any workman who is in receipt of the half monthly payment shall, if so required, submit himself to such examination from time to time. If a workman refuses to be so examined when required to do so by the employer, or by the Commissioner, or in any way obstructs the same, his right to compensation shall be suspended during

the continuance of such refusal or obstruction, unless in the case of refusal he was prevented by sufficient cause from so submitting himself. If a workman before the expiry of the 3 days within which he is liable to be required to submit himself for medical examination voluntarily leaves without having been so examined the vicinity of the place in which he was employed, his right to compensation shall be suspended until he returns and offers himself for such examination. Where a workman whose right to compensation has been suspended dies, without having submitted himself for medical examination as required above, the Commissioner may, if he thinks fit, direct the payment of compensation to the dependants of the deceased workman. Where an injured workman has refused to be attended by the qualified medical practitioner whose services have been offered to him by the employer free of charge, or having accepted such offer has deliberately disregarded the instructions of such medical practitioner, then if it is thereafter proved that the workman has not been regularly attended by the qualified medical practitioner and that such refusal, failure or disregard, was unreasonable in the circumstances, and that the injury has been aggravated thereby, the injury and the resulting disablement shall be deemed to be of the same nature and direction as they might reasonably have been expected to be, if the workman had been regularly attended by a qualified medical practitioner, and compensation if any shall be payable accordingly.

#### Remedies of employer against stranger

Where a workman has recovered compensation in respect of an injury caused under circumstances creating a legal liability of some person, other than the person by whom the compensation was paid, to pay damages in respect thereof, the employer who paid the compensation shall be entitled to be indemnified by the person so liable to pay damages, as aforesaid. (Sec. 3)

#### Commissioners

If any question arises in any proceedings under this Act as to the liability of any person to pay compensation (including any question as to whether a person injured is, or is not a workman) or as to the amount or duration of compensation (including any

question as to the nature or extent of the disablement), the question shall, in default of agreement be settled by a Commissioner. No Civil Court shall have jurisdiction to settle, decide, or deal with any question which is by, or under this Act, required to be settled, decided, or dealt with by a Commissioner, or to enforce any liability under this Act, (Sec. 19). The Local Government may appoint any person by notification in the Gazette to be a Commissioner for workmen's compensation for such local area as may be specified in the notification. A Commissioner may choose one or more persons possessing special knowledge of any matter relevant to the matter under enquiry, to assist him in holding the enquiry and deciding the matter for decision. A Commissioner under the Act is a public servant within the meaning of the Indian Penal Code. A Commissioner may, if he thinks fit, submit any question of law for the decision of the High Court and if he does so, he shall decide the question in conformity with such decision. Against the orders of the Commissioner noted below an appeal can be preferred to the High Court. viz. :

(i) An order awarding as compensation a lump sum, whether by way of redemption of a half-monthly payment or otherwise, or disallowing a claim in full or in part, for a lump sum.

(ii) An order refusing to allow redemption of half-monthly payment.

(iii) An order providing for distribution of compensation among dependants of the deceased workman, or disallowing any claim of an alleged dependant,

(iv) An order allowing or disallowing any claim for the amount of an indemnity under Sec. 12.

(v) An order refusing to register an agreement or registering the same subject to conditions.

No appeal shall lie against any order unless there is a substantial question of law, and unless in the case of an order other than an order referred to in clause (ii) above, unless the amount in dispute in the appeal is not less than Rs. 300. Further no appeal lies where the parties have agreed to abide by the decision of the Commissioner, or in which the order of the Commissioner gives effect to an agreement come to by the parties. The period of limitation for preferring an appeal is 60 days (Sec. 30).

## APPENDIX—C

### THE TRADE UNIONS ACT

(XVI of 1926)

This Act was passed by the Central Legislature with a view to provide for the registration of Trade Unions, and in certain respects to define the law relating to the said Trade Unions in British India. It is applicable to the whole of British India.

#### Definitions

*'Executive'* means the body, by whatever name called, to which the management of the affairs of a Trade Union is entrusted ;

*'Registered Office'* means that office of a Trade Union which is registered under this Act as the head office thereof ;

*'Registered Trade Union'* means a Trade Union registered under this Act ;

*'Trade dispute'* means any dispute between employers and workmen or between workmen and workmen, or between employers and employers, which is connected with the employment or non-employment, or the terms of employment or the conditions of labour, of any person, and "*workmen*" means all persons employed in the trade or industry whether or not in the employment of the employer with whom the trade dispute arises : and

*'Trade Union'* means any combination, whether temporary or permanent, formed primarily for the purpose of regulating the relations between workmen and employers, or between workmen and workmen, or between employers and employers, or for imposing restrictive conditions on the conduct of any trade or business and includes any federation of two or more Trade Unions.

#### Registration of Trade Unions

Every Local Government shall appoint a person to be the Registrar of Trade Unions for the province.

Any seven or more members of a Trade Union may by subscribing their names to the rules of the Trade Union and by other-

wise complying with the provisions of this Act with respect to registration apply for registration of the Union under this Act. Every such application shall be made to the Registrar and shall be accompanied by a copy of the rules of the Trade Union and a statement of the following particulars :—

- (i) names, occupations and addresses of the applicants ;
- (ii) the name of the Trade Union and the address of its head office ;
- (iii) the names, titles, ages, addresses and occupation of the officers of the Trade Union.

If the Trade Union has been in existence for more than an year before the making of the application for registration, the applicants shall submit to the Registrar a general statement of the assets and the liabilities of the Trade Union.

#### Provisions to be contained in the Rules of Trade Union

A Trade Union shall not be registered under the Act unless the executive thereof is constituted in accordance with the provisions of this Act and the rules thereof provide for the following matters, viz. :

- (1) the name of the Trade Union ;
- (2) the objects for which it has been established ;
- (3) the purposes for which its general funds shall be applicable, all of which shall be purposes to which such funds are lawfully applicable under the Act ;
- (4) maintenance of a list of its members, and adequate facilities for the inspection thereof by its officers and members ;
- (5) the admission of ordinary members who shall be persons actually engaged or employed in an industry with which the Trade Union is connected, and also the admission of the number of honorary or temporary members as officers to form the executive of the Trade Union. But not less than one half of the total number of its officers shall be persons actually engaged or employed in the industry with which it is connected ;
- (6) the conditions under which any member shall be entitled to any benefit assured by the rules and under which any fine or forfeiture may be imposed on the members ;
- (7) the manner in which the rules shall be amended, varied or rescinded ;
- (8) the manner in which the members of the executive and the other officers of the Trade Union shall be appointed and removed ;
- (9) the safe custody of the funds of the Trade Union, an annual audit of the accounts thereof and adequate facilities for the inspection of the account



books by officers and members of the Trade Union, and lastly the manner in which the Trade Union may be dissolved. (Sec. 6.)

Further particulars may be required by the Registrar, to satisfy himself that an application complies with Sec. 5, or that it is entitled to registration under Sec. 6, and he may refuse to register until such information is furnished. The Registrar may also refuse to register a Union if its name is identical with, or very nearly resembles the name of another Union, which is likely to deceive the public, or the members of either Union. (Sec. 7.) On registering the Union the Registrar shall issue a certificate of registration in the prescribed form, which shall be conclusive evidence that the Trade Union has been duly registered under this Act (Sec. 9). A certificate already granted may be withdrawn or cancelled by the Registrar : (i) on the application of the Trade Union or (ii) if the certificate has been obtained by fraud or mistake, or the Union has ceased to exist, or has wilfully and after notice contravened any provisions of this Act (Sec. 10).

*Note :—*An appeal can be preferred against an order of the Registrar refusing to register a Trade Union or withdrawing or cancelling registration (Sec. 11).

### **Rights and liabilities of Registered Trade Unions**

#### *Objects on which general funds may be spent :—*

The general funds of a Registered Trade Union shall not be spent on any other objects than the following :—

(1) the payment of salaries, allowances and expenses to officers of the Trade Union ;

(2) the payment of expenses for its administration including audit of the accounts of its general funds ;

(3) the prosecution or defence of any legal proceeding to which the Trade Union or any member thereof is a party, when it is undertaken for securing or protecting any rights of the Union as such, or any rights arising out of the relations of any member with his employer, or with a person whom the member employs ;

(4) the conduct of trade disputes on behalf of the Union or any member thereof ;

(5) the compensation of members for loss arising out of trade disputes ;

(6) allowance to members or their dependants on account of death, old age, sickness, accidents or unemployment of such members ;

(7) the issue of, or the undertaking of liability under, policies of assurance on the lives of members, or under policies insuring members against sickness, accident or unemployment ;

(8) the provision of educational, social or religious benefits for its members or for their dependants ;

(9) the upkeep of a periodical published mainly for the purpose of discussing questions affecting employers or workmen as such ;

• (10) the payment, in furtherance of any of the objects on which its general funds may be spent, of contributions to any cause intended to benefit workmen in general. But such expenditure in any year shall not at any time during that year be in excess of  $\frac{1}{4}$  of the combined total of the gross income which has up to that time accrued to the general funds of the Trade Union during that year, and of the balance at the credit of those funds at the commencement of that year ; and

(11) subject to any conditions contained in the notification, any other object notified by the Governor-General in Council in the Gazette of India. (Sec. 15).

### **Constitution of a separate fund for political purposes**

A registered Trade Union may constitute a separate fund from contributions separately levied for or made to that fund, from which payments may be made for the promotion of the civic and political interests of its members and furtherance of any of the objects specified hereunder, viz. :

(1) the payment of any expenses incurred by a candidate for election as a member of any legislative body constituted under the Government of India Act or of any local authority;

(2) the holding of any meeting or the distribution of any literature or documents in support of any such candidate ; or

(3) the maintenance of any person who is a member of any legislative body constituted under the Government of India Act or any Local authority ; or

(4) the registration of electors or the selection of a candidate for any such legislative body or Local authority ; or

(7) the holding of political meetings of any kind or distribution of political literature or documents of any kind.

The contribution to this fund cannot be made compulsory nor can any member who does not contribute to it be excluded from any benefits of the Union, or be under any disability or any disadvantage compared with other members who contribute to the said fund. Nor can the contribution to the said fund be made a condition for admission to the Trade Union. (Sec. 16).

### **Immunity from Criminal and Civil Liability**

No officer or member of a registered Trade Union shall be liable for punishment under sub-sec. 2 of Sec. 120-B of the Indian Penal Code (criminal conspiracy to commit an offence punishable with rigorous imprisonment not exceeding two years)

in respect of any agreement made between the members for the purpose of furthering any such object of the Trade Union as is specified in Sec. 15 supra, unless the agreement is an agreement to commit an offence. (Sec. 17.)

No suit or other legal proceeding shall be maintainable in any Civil Court against any registered Trade Union, or any officer or member thereof, in respect of any act done in contemplation or furtherance of a trade dispute to which a member of the Union is a party, on the ground only that such act induces some person to break a contract of employment, or that it is in interference with the trade, business or employment of some other person, or with the right of some other person to dispose of his capital or of his labour as he wills. A registered Trade Union shall not be liable in any suit or other legal proceeding in any Civil Court in respect of any tortious act done in contemplation or furtherance of a trade dispute by an agent of the Union if it is proved that such person acted without the knowledge of, or contrary to express instructions given by the executive of the Union. (Sec. 18).

It may be noted that an agreement between the members of a registered Trade Union shall not be void or voidable merely by reason of the fact that any of the objects of the agreement are in restraint of trade. (S. 19).

Any person who has attained the age of 15 years may be a member of a registered Trade Union and may be subject to its rules, and enjoy all the rights of a member and execute all instruments and give all acquittances necessary to be executed or given under the rules. But a person who has not attained the age of 18 years cannot be an officer of a Trade Union.

#### Dissolution

When a registered Trade Union is dissolved, notice of the dissolution signed by seven members and by the Secretary of the Trade Union shall, within fourteen days of the dissolution, be sent to the Registrar, and shall be registered by him if he is satisfied that the dissolution has been effected in accordance with the rules of the Trade Union, and the dissolution shall have effect from the date of such registration. Where the dissolution of a registered Trade Union has been registered, and the rules of the Trade Union do not provide for the distribution of funds of the Trade Union on dissolution, the Registrar shall divide the funds amongst the members in such manner as may be prescribed.

APPENDIX—D  
THE TRADE DISPUTES ACT  
(VII OF 1929)

This Act was passed with a view to provide for the investigation and settlement of trade disputes, and for certain other purposes mentioned in the Act. It extends to the whole of British India.

**Definitions**

*'Board'* means a Board of Conciliation constituted under this Act.

*'Court'* means a Court of Inquiry constituted under this Act.

*'Employer'* in the case of any industry, business or undertaking carried on by any department of the Government, means the authority prescribed in this behalf or, where no authority is prescribed, the head of the department.

*'Lock-out'* means the closing of a place of employment, or the suspension of work, or the refusal by an employer to continue to employ any number of persons employed by him, where such closing, suspension or refusal occurs in consequence of a dispute and is intended for the purpose of compelling those persons, or of aiding another employer in compelling persons employed by him, to accept terms or conditions of, or affecting employment.

*'Public utility service'* means :—

(i) any railway service which in the case of a Federal Railway, the Central Government, and in the case of other railway the Provincial Government, may, by notification in the Official Gazette declare to be a public utility service for the purposes of this Act ; or

(i-a) any water transport service carrying passengers, to whose vessels any of the provisions of the Indian Steam Vessels Act 1917 apply, or tramway service, if the Provincial Government by notification in the Official Gazette declares the water transport or tramway service, as the case may be, to be a public utility service for the purposes of the Act; or;

- (ii) any postal, telegraph or telephone service ; or
- (iii) any industry, business or undertaking which supplies light or water to the public ; or
- (iv) any system of public conservancy or sanitation.

'*Strike*' means a cessation of work by a body of persons employed in any trade or industry acting in combination, or a concerted refusal, or a refusal under a common understanding, of any number of persons who are or have been so employed to continue to work or to accept employment.

'*Trade dispute*' means any dispute or difference between employers and workmen, or between workmen and workmen, which is connected with the employment or non-employment on the terms of the employment, or with the conditions of labour of any person.

'*Workman*' means any person employed in any trade or industry to do any skilled or unskilled manual or clerical work for hire or reward, but does not include any person employed in the naval, military or air service of the Crown or in the Royal Indian Marine Service.

#### Reference of disputes to Courts and Boards

If any trade dispute exists or is apprehended between an employer and any of his workmen, the Provincial Government or, where an employer is the head of the department under the control of the Central Government or is the Federal Railway authority or a Railway Company operating a Federal Railway, the Central Government, may by order in writing :

(a) refer any matters appearing to be connected with or relevant to the dispute to a Court of Inquiry to be appointed by the Provincial Government or the Central Government as the case may be ; or

(b) refer the dispute to a Board of Conciliation to be appointed by the Provincial Government or the Central Government as the case may be, for promoting a settlement thereof ;

Provided that where both parties to the dispute apply, whether separately or conjointly for a reference to a Court, or where both parties apply whether separately or conjointly for a reference to a Board, and the authority having the power to appoint is satisfied

that the persons applying represent the majority of each party, a Court or a Board, as the case may be, shall be appointed accordingly. (Sec. 3).

#### **Constitution and duties of Courts of enquiry**

A Court shall consist of an independent chairman and such other independent persons as the appointing authority thinks fit, or may, if such authority thinks fit, consist of one independent person. (Sec. 4). A Court shall either in public or in private, at its discretion, inquire into the matters referred to it and report thereon to the authority by which the Court was appointed. It may if it thinks fit make interim reports (Sec. 5).

#### **Constitution and duties of Boards of Conciliation**

A Board shall consist of a Chairman and two or four other members as the appointing authority thinks fit, or may, if such authority thinks fit consist of one independent person (Sec. 6). Where a dispute has been referred to a Board under this Act, it shall be the duty of the Board to endeavour to bring about a settlement of the same, and for this purpose it shall, in such manner as it thinks fit and without delay, investigate the dispute and all matters affecting the merits thereof and the right settlement thereof, and in so doing may do all such things as it thinks fit for the purpose of inducing the parties to come to a fair and amicable settlement of the dispute, and may adjourn the proceedings for any period sufficient in its opinion to allow the parties to agree upon the terms of settlement. If a settlement has been arrived at, the memorandum of the settlement shall be drawn up by the Board and signed by the parties, and the Board shall send a report of the settlement together with the memorandum to the authority by which it was appointed. If no such settlement is arrived at, the Board shall send a full report regarding the dispute to the authority by which it was appointed stating the proceedings and steps taken by it for the purpose of ascertaining the facts and circumstances relating to the dispute and of bringing about a settlement thereof, together with a full statement of such facts and circumstances and its finding thereon, and the recommendation of the Board for the determination of the dispute. The recommendation shall also state what in the opinion of the Board ought and ought not to be done by the respective parties. (Sec. 7).

*Note :—*The report of a Court, or a Board shall be signed by all its members, and the final as well as the interim reports of a Court or a Board, with any minute of dissent, shall as soon as they are received by the appointing authority be published by that authority.

### Special provisions regarding public utility services

(1) Any person who, being employed in a public utility service, goes on strike in breach of contract without having given to his employer, *within one month* before so striking, not less than *fourteen days* previous notice in writing of his intention to go on strike or, having given such notice, goes on strike before expiry thereof, shall be punishable with imprisonment which may extend to one month, or with fine which may extend to fifty rupees or with both.

(2) Any employer carrying on any public utility service who locks out his workmen in breach of contract without having given them, *within one month* before such lock-out not less than *fourteen days* notice in writing of his intention to lock them out, or having given such notice, locks them out before the expiry thereof, shall be liable to imprisonment which may extend to one month or to a fine which may extend to Rs. 1000 or with both.

(2-A) If on any day an employer receives from any persons employed by him any such notices as are referred to in sub-section (1), or gives to any person employed by him any such notices as are referred to in sub-section (2), he shall within five days report to the Provincial Government, or such authority as Provincial Government may prescribe, the number of such notices received or given on that day, and if he fails to do so he shall be punishable with fine which may extend to five hundred rupees.  
(Sec. 15.)

### Special provisions for illegal strikes and lock-outs

1. A strike or a lock-out shall be illegal which :

(a) has any object other than, or in addition to, the furtherance of a trade dispute within the trade or industry in which the strikers or employers or employers locking out are engaged ; and

(b) is designed or calculated to inflict severe, general and prolonged hardship upon the community and thereby to compel

the Government to take or abstain from taking any particular course of action.

2- It shall be illegal to commence, or continue, or to apply any sums in direct furtherance or support of any such illegal strike or lock-out.

3. For the purposes of this section :

(a) a trade dispute shall not be deemed to be within a trade or industry unless it is a dispute between employers and workmen or between workmen and workmen, in that trade or industry, which is connected with the employment or non-employment or the terms of the employment, or with the conditions of labour, of persons in that trade or industry ;

(b) without prejudice to the generality of the expression "trade or industry" workmen shall be deemed to be within the same trade or industry if their wages or conditions of employment are determined in accordance with agreement made with the same employer or group of employers.

4. A strike or a lock-out shall not be deemed to be calculated to compel the Government unless such compulsion might reasonably be expected as a consequence thereof (Sec. 16).

*Note:—*Any person who declares instigates, incites others to take part in, or otherwise acts in furtherance of, a strike or lock-out which is illegal under Sec. 16 (supra) is liable to be punished with imprisonment which may extend to 3 months, or with fine which may extend to Rs. 200, or with both. But a person shall not be deemed to have committed this offence by reason only of his having ceased work or refused to continue to work or to accept employment. (Sec. 17). Further no person refusing to take part, or to continue to take part in any strike or lock-out which is illegal can, by reason of such refusal, be subject to expulsion from any Trade Union, or any fine or penalty, or deprivation of any right or benefit to which he would otherwise be entitled, or be liable to be placed under any disability or disadvantage compared with other members of the union or society, anything to the contrary in the rules of a Trade Union or Society notwithstanding (Sec. 18). Sec. 18-A contemplates the appointment of conciliation officers by the Central and Provincial Governments for the purpose of mediating or promoting the settlement of a trade dispute.



## APPENDIX—E

### THE SOCIETIES REGISTRATION ACT

(XXI OF 1860)

This Act was passed with the object of improving the legal condition of societies established for the promotion of literature, science, or the fine arts, or for the diffusion of useful knowledge, the diffusion of political education or for charitable purposes.

#### Procedure for Registration under the Act

Any seven or more members associated for any literary, scientific, or charitable purpose, or any such purpose as is described in sec. 20 of this Act may, by subscribing their names to a memorandum of association and filing the same with the Registrar of Joint Stock Companies form themselves into a society under this Act (Sec. 1).

*Note* :—Sec. 20 lays down that the following societies may be registered under this Act :

Charitable societies, the military orphan funds, or societies established at the several presidencies of India, societies established for the promotion of science, literature, or the fine arts, for instruction, the diffusion of useful knowledge, the diffusion of political education, the foundation or maintenance of libraries or reading-rooms, for general use among the members or open to the public or public museums, and galleries of painting and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.

The memorandum of association of every society shall contain the following :

- (i) the name of the society ;
- (ii) the objects of the society :
- (iii) the names, addresses, and occupations of the governors, council, directors, committee or other governing body to whom, by the rules of the society the management of its affairs is entrusted.'

A copy of the rules and regulations of the society, certified to be a correct copy, by not less than 3 members of the governing body, shall be filed with the memorandum of association. (Sec. 2)

Upon such memorandum and certified copy being filed, the Registrar shall certify that the society is registered under this Act (Sec. 3).

### Consequences of Registration

Once in every year, on or before the 14th day succeeding the day on which according to the rules of the society the annual general meeting of the society is held, or if the rules do not provide for an annual general meeting, in the month of January, a list shall be filed with the Registrar of Joint Stock Companies, of the names, addresses and occupations of the governors, council, directors, committee or other governing body then entrusted with the management of the affairs of the society. (Sec. 4).

*Property of society how vested* :—The property, moveable and immoveable belonging to the society registered under this Act, if not vested in trustees, shall be deemed to be vested for the time being in the governing body of such society and in all proceedings, civil and criminal, may be described as the property of the governing body of such society by their proper title. (Sec. 5)

*Suits by and against society* :—Every society registered under this Act may sue or be sued in the name of the president, chairman, or principal, secretary, or trustees, as shall be determined by the rules and regulations of the society, and, in default of such determination, in the name of such person as shall be appointed by the governing body for the occasion. It shall however be competent for any person having a claim or demand against the society to sue the president, or chairman, or principal secretary, or the trustees thereof, if on application to the governing body some other officer or person be not nominated to be the defendant. No suit or proceeding in any Civil Court shall abate, or discontinue, by reason of the person against whom such suit or proceedings shall have been brought or continued, dying or ceasing to fill the character in the name whereof he shall have sued or been sued, but the same suit or proceedings shall be continued in the name of or against the successor of such person (Secs. 6 and 7).

*Enforcement of judgment against society* :—If a judgment shall be recovered against the person or officer named on behalf of the society, such judgment shall not be put in force against

the property, moveable or immoveable or against the body of such person or officer, but against the property of the society. (Sec. 8).

*Recovery of penalty accruing under bye-law:*—Any penalty recoverable from any member under any bye-law, on account of the breach of any rule or bye-law of the society, committed by him, when accrued, may be recovered in any Court having jurisdiction where the defendant shall reside, or the society shall be situate, as the governing body thereof shall deem expedient (Sec. 9).

*Members liable to be sued as strangers:*—Any member who may be in arrear of a subscription, which according to the rules of the society he is bound to pay, or who shall possess himself of, or detain any property of the society in a manner or for a time contrary to such rules, or shall injure or destroy any property of the society, may be sued for such arrear, or for the damage accruing from such detention, injury or destruction of property in the manner herein before provided. If the defendant be successful in any suit or proceeding and be entitled to costs against the society, he may elect to proceed to recover the same from the officer in whose name a suit shall be brought or from the society. In the latter case he shall have his remedy against the property of the society as stated above. (Sec. 10). Members of the society who steal or purloin or embezzle any money or other property, or wilfully and maliciously destroy or injure any property of the society, or forge any document whereby the funds of the society may be exposed to loss, shall be subject to the same prosecution, and if convicted, to the same punishment as any person not a member would be subject and liable to in respect of the like offence.

#### Mode of altering the purposes of society

Whenever it shall appear to the governing body of any society registered under this Act, which has been established for any particular purpose or purposes, that it is advisable to alter, extend, or abridge such purpose to or for other purposes within the meaning of this Act, or to amalgamate such society either wholly or partially with any other society, such governing body may submit the proposition to the members of the society in a written or printed report and may convene a special meeting for

the consideration thereof according to the regulations of the society ;

but no such proposition shall be carried into effect unless such report shall have been delivered or sent by post to every member of the society *ten days* previous to the *special meeting* convened by the governing body for the consideration thereof, nor unless such proposition shall have been agreed to by the votes of *three-fifths* of the members delivered in person or by proxy, and confirmed by the votes of *three-fifths* of the members present at a *second special meeting* convened by the governing body at an *interval of one month* after the former meeting. (Sec. 12).

#### Provision for dissolution of societies and adjustment of their affairs

Any number *not less than three-fifths* of the members of any society may determine that it shall be dissolved, and thereupon it shall be dissolved forthwith, or at the time then agreed upon, and all necessary steps shall be taken for the disposal and settlement of the property of the society, its claims and liabilities, according to the rules of the said society applicable thereto, if any, and, if not, then as the governing body shall find expedient, provided that, in the event of any dispute arising among the said governing body or the members of the society, the adjustment of its affairs shall be referred to the principal Court of original civil jurisdiction of the district in which the chief building of the society is situate ; and the Court shall make such order in the matter as it shall deem requisite :

*Assent required* :—Provided that no society shall be dissolved unless *three-fifths* of the members shall have expressed a wish for such dissolution by their votes delivered in person, or by proxy, at a *general meeting* convened for the purpose.

*Government consent* :—Provided that whenever the Government is a member of, or a contributor to, or otherwise interested in, any society registered under this Act, such society shall not be dissolved without the consent of Government. (Sec. 13).

*Distribution of property after dissolution* :—Any property whatsoever, of the society remaining after the satisfaction of its debts and liabilities shall not be paid or distributed among the members of the said society or any of them, but shall be given to

some other society, to be determined by the votes of not less than *three-fifths* of the members present personally or by proxy at the time of the resolution, or in default thereof by such Court as aforesaid. This clause however shall not apply to any society founded or established by the contributions of share-holders in the nature of a Joint Stock Company. (Sec. 14).

#### Miscellaneous provisions

In order that a person may be a member of a society under this Act he should have been admitted therein according to the rules and regulations thereof, and should have paid the subscription, or signed the roll of list of members thereof, and should not have resigned in accordance with such rules and regulations. No person shall be entitled to vote or to be counted as a member whose subscription at the time shall have been in arrear for a period exceeding three months (Sec. 15). The governing body of the society shall be the governors, council, directors, committee, or trustees, or other body to whom by the rules and regulations of the society the management of its affairs is entrusted. Any company or society established for a literary, scientific, or charitable purpose, and registered under Act XL of 1850, or any such society not so registered, may at any time be registered as a society under this Act, provided the assent to its being so registered has been given by *three-fourths* of its members present personally or by proxy at some general meeting convened for that purpose. (Sec. 17).

FINIS

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